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In The Supreme Court Of The United States

OCTOBER TERM, 1991

KAISER STEEL RESOURCES, INC., formerly known as KAISER STEEL CORPORATION, *Petitioner*
v.
PEARL BREWING COMPANY, et al., and SECURITIES AND EXCHANGE COMMISSION, *Respondents*

KAISER STEEL RESOURCES, INC., formerly known as KAISER STEEL CORPORATION, *Petitioner*
v.
ACTION TRADERS, INC., et al., and SECURITIES AND EXCHANGE COMMISSION, *Respondents*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTION PRESENTED

When a corporate distribution is made to shareholders that leaves the company insolvent, a long-standing remedy of corporate creditors and the corporation's bankruptcy trustee is to avoid that transaction and recover the funds for payment to creditors, especially where the shareholders are informed in advance that the transaction may impair the company's financial condition. Does section 546(e) of the Bankruptcy Code, exempting "settlement payments" from bankruptcy avoidance powers, eliminate that remedy?

LIST OF PARTIES

Kaiser Steel Resources, Inc., a reorganized debtor upon confirmation of the Chapter 11 Plan of Kaiser Steel Corporation and its subsidiaries, was the sole plaintiff-appellant in each of two consolidated cases in the Tenth Circuit (Nos. 90-1243 and 90-1245) and is the sole petitioner here. The Tenth Circuit captions (in Petition Appendix A at 1A-8A) list 269 defendants/appellees, but 32 were dismissed by Tenth Circuit orders dated October 10 & 24, 1990, and February 12 & March 14, 1991; the remaining defendants/appellees, being exceptionally numerous, are listed in Appendix L; they are respondents here. The Securities and Exchange Commission, as a party in interest under 11 U.S.C. § 1109(a), was the sole additional appellee in each case; accordingly the SEC is an additional respondent here.

RULE 29.1 STATEMENT

Kaiser Steel Resources, Inc. is a corporate reorganized debtor, having had a Chapter 11 plan of reorganization confirmed, under the jurisdiction of the United States Bankruptcy Court for the District of Colorado. Its name was formerly Kaiser Steel Corporation; it has no parent companies, owns 51% of Fontana Union Water Company, and wholly owns other subsidiaries.

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Kaiser Steel Resources, Inc., formerly known as Kaiser Steel Corporation, hereby petitions for a writ of certiorari to review the decision and judgment of the United States Court of Appeals for the Tenth Circuit in two consolidated cases, known there as No. 90-1243, *Kaiser Steel Corp. v. Pearl Brewing Co., et al.*, and No. 90-1245, *Kaiser Steel Resources, Inc. v. Action Traders, Inc., et al.*

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit (App. A) in this case is reported at 952 F.2d 1230. The August 10, 1990 order of the United States District Court for the District of Colorado in this case is set forth in Appendix H.

JURISDICTION

The opinion and judgment of the Tenth Circuit were entered December 30, 1991 (App. A). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The relevant provisions of the Bankruptcy Code, 11 U.S.C. §§ 362(b)(6), 546(e), 550(a), 741(7) and 741(8), are set forth in full in Appendix K. The key section, 546(e), provides that notwithstanding a bankruptcy trustee's fraudulent conveyance, preference, and other avoidance powers, he "may not avoid a [prepetition] transfer that is a . . . settlement payment, as defined in section . . . 741(8) of this title, made by or to a . . . stockbroker, financial institution, or securities clearing agency," unless actual intent to defraud within one year of bankruptcy is proved. The settlement payment definition refers to a preliminary, partial, interim or final settlement payment, "or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8).

STATEMENT OF THE CASE

Like many bankruptcy proceedings, this case entails a seemingly complex procedural history. But the question which emerges

for consideration by this Court is clear, relatively simple, and very important: Should section 546(e) be read to turn the Bankruptcy Code upside down by preferring equity over debt?

In 1984, Kaiser Steel Corporation underwent a leveraged buyout ("LBO") whereby $162,000,000 was paid to holders of its publicly traded common stock, its cash was substantially depleted and its remaining assets encumbered, and an outside group took over the company by merger. The majority of the shares were beneficially owned by arbitrageurs and knowledgable insiders when the cash was distributed. Kaiser, rendered insolvent, has been prevented from recovering these millions of dollars for its creditors, including desperately needy retirees, based on a novel interpretation of a Bankruptcy Code provision intended to deal with other problems.

1. The Nature of Kaiser's LBO.

In late 1983, all Kaiser Steel shareholders received a proxy and prospectus, proposing what was clearly described as an LBO of all outstanding stock in Kaiser Steel. Kaiser would borrow an additional $100 million encumbering all its remaining assets; Kaiser would drain another $62 million of its cash on hand; then Kaiser would distribute to shareholders for their outstanding shares $162 million plus preferred stock in the newly formed acquiring company. The Frates Group, forming and owning the new company, would contribute virtually nothing.

Since Kaiser Steel had been posting substantial operating losses and had recently closed its steel mills, the proposal undoubtedly was attractive. Over 14.6 million shares of Kaiser stock were traded after the first announcement of a prospective takeover, at escalating prices that more than doubled, including 1.4 million after the prospectus. In the buying spree, the investment bankers and brokers joined the institutional investors holding the bulk of Kaiser's stock, to take advantage of the LBO. By the time the cash

was distributed, the shareholders consisted largely of market players and arbitrageurs. Thus, for example, when Kaiser distributed its LBO cash, Goldman Sachs, advisor to the Frates Group, received over $10.2 million for its own account. Smith Barney likewise kept over $5.3 million for its house account; Alpine Associates $5.3 million; Kellner DiLeo $4.2 million; O'-Connor Securities $3.4 million; Drexel Burnham over $2.6 million; L.F. Rothschild over $2.4 million; Dillon Read over $1.9 million.

Before the Frates Group proposed its LBO terms, an investment group headed by Irwin Jacobs acquired enough stock to make it the largest of Kaiser's shareholders. Jacobs' announcement of stock purchases stimulated arbitrage buying by others. The Jacobs Group acquired detailed, confidential information about Kaiser when it agreed in principle to acquire the company. Jacobs withdrew that offer, on the grounds that Kaiser's financial condition was much worse and its contingent liabilities were much greater than the Jacobs Group initially believed. The Jacobs Group submitted other offers, but finally negotiated an option whereby Kaiser paid it $14.5 million not to oppose the Frates Group LBO; the shareholders were informed that the option was a necessary condition to paying themselves. Stephens, Inc., Jacobs' broker, acquired its own Kaiser shares and received over $4.8 million for them. Stephens' owners took another $286,000 of LBO cash for the shares they bought personally.

If certiorari is granted and Kaiser is permitted to proceed to trial, the information already obtained in discovery and from other sources will show that once the $162 million was distributed to the shareholders and the new $100 million in debt was shouldered in 1984, Kaiser's liabilities exceeded its assets by almost $500 million; it was undercapitalized, and unable to pay its trade creditors, its workers and retiree benefits, and its environmental commitments. The impact was real and immediate to Kaiser's retirees and their dependents, whose numbers had increased by thousands after Kaiser shut down its steel mills. Within

months after the LBO closed, independent accountants confirmed to the United Steelworkers the company's claims that it could not survive without slashing retiree medical benefits by $100 million. The retirees were forced to agree to a few thousand dollar payout or reduced benefits, or lose all benefits on January 1, 1985.

2. The LBO Mechanics.

The LBO process involved taking Kaiser stock out of the public market, not transfers of stock between shareholders. A new Kaiser Acquisition Corporation was formed, and merged into the old Kaiser effective February 29, 1984. Each share of Kaiser's old stock was thereby converted into the right to receive a distribution of $22 cash per share and newly issued preferred Kaiser stock. On February 29, Kaiser authorized its disbursement agent to arrange for surrender of the common stock certificates, and paid it the funds to distribute to anyone who turned in certificates or affidavits of lost certificates. The Kaiser common stock was delisted on the exchanges on March 1, 1984. Shareholders turned in their certificates, the agent reviewed them and reconciled any discrepancies, then disbursed the promised $162 million to them beginning March 7 or 8, 1984, and continuing over the next two years as certificates were turned in and processed.

Most of the distributions were processed through depository clearing agencies having accounts for brokerage companies and banks to reflect ownership of stock in their own names and in street name for customers. The depositories as "record holders" turned in the stock certificates, and credited the Kaiser funds immediately upon receipt to their member accounts. The brokers and banks in turn kept the money for their own accounts, or at some point credited their customers' accounts.

3. Kaiser's Bankruptcy.

Kaiser sold substantial assets in 1984, 1985 and 1986 to fund its LBO, but still fell short. By 1986, Kaiser had failed to pay

preferred stock dividends and deposits, failed to pay minimum pension plan contributions, and was significantly in arrears on trade payables, secured loans and lease obligations. Kaiser filed a Chapter 11 bankruptcy case in February 1987 in the United States Bankruptcy Court in Colorado, then filed the litigation at issue here to retrieve its distributions from shareholders on fraudulent conveyance grounds.

Kaiser confirmed a reorganization plan in 1988. The plan provides that its recoveries from this suit, and from related LBO litigation against Kaiser's directors and LBO advisors, and litigation to recover subsequent transfers of property and cash, are used to fund retiree medical and pension trusts and pay unsecured creditors. Kaiser's 7,000-plus retirees represent its largest block of unsecured creditors; over 64% of them have dependents. The vast majority that had not accepted a cash settlement after the LBO, and were still depending on Kaiser medical insurance, lost their remaining insurance benefits altogether a few weeks before the bankruptcy filing. They struggled without any benefits until temporary arrangements with further reduced coverage could be made, a year and a half later, because the company simply lacked the funds to comply with a federal law requiring payment of such benefits. Kaiser's life and medical insurance benefits cost $14 million a year in 1986, before the bankruptcy filing. Despite health care inflation and an aging population, Kaiser managed only $7 million for interim benefits during the pendency of the bankruptcy case.

At plan confirmation, Kaiser's accountants calculated the present value of Kaiser's liability for retiree medical benefits, without even accounting for retirees with long-term disabilities or child dependents, or for active workers, at $350 to $500 million. The retiree medical benefits claimants will receive distributions from a Retiree Medical Benefits Trust established under Kaiser's plan. The trust can pay benefits only as long as the trust assets last

— consisting of stock in reorganized Kaiser bringing some price on the market plus litigation recoveries. This trust receives 55% of the net litigation proceeds.

The retirees also have claims for pension benefits in excess of amounts guaranteed by the Pension Benefit Guarantee Corporation ("PBGC"), because Kaiser had promised its workers pension supplements of $400 a month. These supplements were halted during the bankruptcy for lack of cash, leaving retirees only the minimum PBGC-guaranteed pension amount to pay living costs and their medical expenses. In addition to the retirees' pension supplement claims, the PBGC has a claim against Kaiser for over $200 million. Under the reorganization plan, the PBGC and other pension claims are satisfied through two retiree trusts distributing directly to pensioners, and receiving 28% of the net litigation proceeds — until those proceeds run out. Kaiser's employees relied on company promises of insurance through retirement, in not arranging other coverage when they were young and healthy. They desperately need to receive proceeds from all legitimate causes of action Kaiser possesses.

Kaiser's unsecured creditors are the remaining beneficiaries of its litigation. Unsecured creditor claims have been estimated at $250 to $500 million; these creditors will share 17% of the net litigation proceeds, along with stock in the reorganized Kaiser.

4. The Present Litigation.

Shortly after its chapter 11 filing, Kaiser sued in the Colorado bankruptcy court to recover its distributions from shareholders on fraudulent conveyance grounds.[1] Because of the mechanics of publicly traded stock ownership, Kaiser had to sue the depository clearing agencies who were recordholders, and the stockbrokers

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[1] Kaiser sued as debtor-in-possession, exercising the avoidance powers granted to it under sections 1107 and 544 of the Bankruptcy Code.

and banks which the depositories identified as having been credited with the funds in various amounts. When the brokers and banks identified customers who ultimately were credited with monies as beneficial shareholders, Kaiser filed a second suit in the same court against the largest of those customers.

Kaiser dismissed the depository clearing agencies from the suit. Discount broker Charles Schwab & Co. proceeded as a "test case" broker/defendant in moving for summary judgment on grounds it could not be liable as an initial transferee of the Kaiser money because it distributed all the money in turn to customers. Due to the precedential effect of such a ruling in the case, other defendants were allowed to file briefs supporting Schwab's motion. One such brief by several broker-dealers claimed that Bankruptcy Code section 546(e) barred any recovery from shareholders, the first time any such assertion had been made in any case, any law review article, or any other source.

The bankruptcy court ruled that summary judgment for defendant Schwab was inappropriate, not only because section 546(e) did not apply, but also because the brokers were liable as transferees under section 550 of the Code (App. B). The district court reversed on appeal, holding Schwab was entitled to summary judgment on both grounds (Apps. E, F). The district court, on a withdrawal of reference from the bankruptcy court (Apps. C, D), then granted summary judgment for the other financial intermediaries on section 546(e) grounds. It further, *sua sponte*, granted summary judgment for all beneficial shareholders as well, carving out only the Jacobs Group for further briefing and argument (Apps. G, H, I).

The Tenth Circuit upheld the district court's *Schwab* ruling, addressing only section 546(e). *Kaiser Steel Corp. v. Charles Schwab & Co., Inc.* (App. J). Kaiser concluded not to challenge further what may be deemed the substantial justice of immunizing financial intermediaries to the extent they acted as mere conduits, although it challenges here the court's rationale for doing so. It has

dismissed its claims against the defendants who established they passed all money through to customers. The remaining defendants/appellees are all beneficial shareholders, in whole or part, and Kaiser has stipulated that it is suing them only to the extent they were beneficial shareholders. The Tenth Circuit's ruling as to those beneficial shareholders, upholding the dismissal of all claims against them, is the subject of this petition. The Jacobs Group's motion for summary judgment on section 546(e) grounds is pending in the district court.

REASONS FOR GRANTING THE WRIT

I. The Tenth Circuit's Decision Is A Major Departure From Fundamental Principles Of Law On Important Matters Going To The Heart Of The Bankruptcy System.

"Settlement payment" can be interpreted within its normal securities trading context, consistent with the rest of the Bankruptcy Code and the fundamental principle that debt is to be paid by an insolvent company before equity. The Tenth Circuit instead sanctified the securities industry, creating a definition beyond that used by the industry, whose scope licenses corporate raiders and all shareholders to plunder corporate assets.

A. The Fundamental Conflict Manifested by the Tenth Circuit's Decision.

In a broad sense, the decision below conflicts with contemporary and venerable case law allowing creditors to recover corporate distributions from shareholders that rendered the company insolvent. As Justice Brandeis wrote for a unanimous Court in *Pierce v. United States*, 255 U.S. 398, 402 (1921):

> The law which sends a corporation into the world with the capacity to act imposes upon its assets liability for its acts. The corporation cannot disable itself from responding by distributing its property among its stockholders and leaving remediless those having valid claims. In such a case the claims

after being reduced to judgments may be satisfied out of the assets in the hands of the stockholders.

Or, as Justice Story wrote a century before, only insolvency, not fraud, need be established to recover corporate distributions from shareholders, because "the capital stock [is] a trust fund for the payment of all debts of the corporation . . . creditors have the first claims upon it; and the stockholders have no rights, until all the other creditors are satisfied." *Wood v. Dummer*, 30 F. Cas. 436 (C.C.D. Maine 1824) (No. 17,944). These fundamental principles have been applied in a long history of cases under the Trust Fund Doctrine; fraudulent conveyance statutes; and corporate statutes prohibiting distributions if the corporation will thereafter be unable to pay its liabilities. [2] The law is just as vibrant and pervasive

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[2] As illustrative cases on the various theories, see:

Trust fund cases: *Curran v. Arkansas*, 56 U.S. (15 How.) 304 (1853); *Phillips-Jones Corp. v. Parmley*, 302 U.S. 233 (1937); *Stone v. First Wyoming Bank*, 625 F.2d 332, 348 (10th Cir. 1980); *Drew v. United States*, 367 F.2d 828 (Ct. Cl. 1966); *Automatic Canteen Co. v. Wharton*, 358 F.2d 587, 589-90 (2d Cir. 1966); *Snyder v. Nathan*, 353 F.2d 3 (7th Cir. 1965); *Bankers Trust Co. v. Hale & Kilburn Corp.*, 84 F.2d 401 (2d Cir. 1936); *Lytle v. Andrews*, 34 F.2d 252 (8th Cir. 1929); *Jahn v. Champagne Lumber Co.*, 157 F. 407 (C.C. Wis. 1908), *aff'd*, 168 F. 510 (C.C.A. Wis. 1909); *Baltimore & Ohio Tel. Co. v. Interstate Tel. Co.*, 54 F. 50 (C.C.A. Md. 1893); *Carson v. Davidson*, 248 Kan. 543, 808 P.2d 1377 (1991); *King v. Coosa Valley Mineral Products Co.*, 283 Ala. 197, 215 So. 2d 275 (1968); *South Carolina Dept. of Social Services v. Winyah Nursing Homes, Inc.*, 282 S.C. 556, 320 S.E.2d 464 (1984); *Fountain v. Burke*, 160 Ga. App. 262, 287 S.E.2d 39 (1981).

Fraudulent conveyance recoveries from shareholders: *In re Roco Corp.*, 701 F.2d 978 (1st Cir. 1983); *Branch v. Steph*, 389 F.2d 233 (10th Cir. 1968); *United States v. Niedorf*, 522 F.2d 916 (9th Cir. 1975), *cert. denied*, 423 U.S. 1087 (1976); *Schafer v. Hammond*, 456 F.2d 15 (10th Cir. 1972); *M.V. Moore & Co. v. Gilmore*, 216 F. 99 (4th Cir. 1914); *In re Jenkins Landscaping & Excavating, Inc.*, 93 B.R. 84, 85 (W.D. Va. 1988); *Stee v. "L" Monte Indus., Inc.*, 247 N.W.2d 641 (N.D. 1976); *Nelson v. Spiegel*, 529 So. 2d 311 (Fla. App. 1988); *Farm Stores, Inc. v. School Feeding Corp.*, 102 A.D. 249, 477 N.Y.S.2d 374 (1984), *aff'd mem.*, 64 N.Y.2d 1065, 489 N.Y.S.2d 877, 479 N.E.2d 222 (1985); *Economy Refining & Serv. Co. v. Royal Nat'l Bank*, 20 Cal. App. 3d 434, 97 Cal. Rptr. 706 (1971);

(continued...)

today; it was applied as recently as January 1992 in *Lippi v. City Bank, et al.*, 1992 U.S. App. LEXIS 634 (9th Cir. Jan. 23, 1992), where the court reversed summary judgment obtained by selling stockholders in a leveraged buyout. The novel aspect of Kaiser's case is the size of the shareholder distribution and unpaid debts, not the law.

These rules were not enforced by the Tenth Circuit because it concluded that use of the term "settlement payment" in Bankruptcy Code section 546(e) nullified the normal rule with respect to shareholder distributions, even as it acknowledged that "[n]either LBOs nor other exceptional [*i.e.*, nontrade] transactions were even mentioned in any of the discussions of the

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[2] *(...continued)*

Spanier v. United States Fidelity & Guaranty Co., 127 Ariz. 589, 623 P.2d 19 (App. 1980); *Johnson v. Canfield-Swigart Co.*, 292 Ill. 101, 126 N.E. 608 (1920); *In re Aluminum Mills Corp.*, 132 B.R. 869 (Bankr. N.D. Ill. 1991); *In re Vadnais Lumber Supply, Inc.*, 100 B.R. 127 (Bankr. D. Mass. 1989); *In re Anderson Industries, Inc.*, 55 B.R. 922 (Bankr. W.D. Mich. 1985).

State Statutes: MODEL BUSINESS CORP. ACT § 6.40 (1987); DEL. CODE ANN. tit. 8, § 160(a)(1); *In re Kettle Fried Chicken of America*, 513 F.2d 807 (6th Cir. 1975); *Jarroll Coal Co. v. Lewis*, 210 F.2d 578 (4th Cir. 1954); *In re Wright Motor Co.*, 299 F. 106 (C.C.A. Cal. 1924); *Thompson v. A.G. Nash & Co., Inc.*, 704 S.W.2d 822 (Tex. App. 1985); *Plastic Contact Lens Co. v. Frontier of Northeast, Inc.*, 324 F. Supp. 213 (W.D.N.Y. 1969), *aff'd*, 441 F.2d 67 (2d Cir.), *cert. denied*, 404 U.S. 881 (1971). Other cases are collected in Macy, Annotation, *Rights of Creditors of Corporation with Respect to its Purchase or Acquisition of its Own Stock*, 47 A.L.R.2d 758 (1956 & Supp. 1980).

See also Louisville Trust Co. v. Louisville, N.A. & C. Ry., 174 U.S. 684 (1899); *Northern Pacific Ry. v. Boyd, 228 U.S. 482, 490-91 (1913); Kansas City So. Ry. v. Guardian Trust Co.*, 240 U.S. 166 (1916); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215 (1941); *Corporation Audit Co. v. Cafritz*, 156 F.2d 839 (D.C. Cir. 1946); *Steinberger v. United States*, 81 F.2d 1008 (9th Cir. 1936); *Hunn v. United States*, 60 F.2d 430 (8th Cir. 1932); *United States v. Seyler*, 142 F. Supp. 408 (W.D. Pa. 1956); *Landers, Frary & Clark v. Vischer Products Co.*, 104 F. Supp. 411 (N.D. Ill. 1952); *Grant T. Munson Chevrolet, Inc. v. General Motors Corp.*, 66 F. Supp. 714 (N.D. Ind. 1946); *Flotte v. United Claims, Inc.*, 657 S.W.2d 387 (Mo. App. 1983), applying the same principles to recover from shareholders in other contexts or without specifying theories.

securities industry in the reports, debates, and hearings on the bill [section 546(e)]." 913 F.2d at 850 (App. J at 9J).

The Tenth Circuit is the first court of appeals case to deal with the applicability of section 546(e) to corporate distributions to shareholders, in an LBO or otherwise, so there is no direct conflict of circuits. However, once the section 546(e) defense was asserted in *Kaiser*, it was raised in the comparable shareholder litigation in the *Wieboldt* and *Revco* bankruptcy cases. A district court in Chicago held that section 546(e) is inapplicable to LBO distributions to all shareholders, and refused to grant a motion to dismiss that litigation. *Wieboldt Stores, Inc. v. Schottenstein*, 131 B.R. 655 (N.D. Ill. 1991). This case is in direct conflict with the decision challenged here, which the Tenth Circuit expressly acknowledged (App. 24A, n.10). The *Wieboldt* case settled on the eve of trial, so it was not addressed by the Seventh Circuit. The *Revco* litigation was dismissed and the claims released under its reorganization plan before any motions were argued. *In re Revco D.S., Inc., et al.*, U.S. Bankruptcy Court, Northern District of Ohio, Nos. 588-1308 - 588-1321, 588-1305, 588-1761 - 588-1812 (3/16/92 order).

The issue presented is of sufficient public importance generally, and of sufficient consequence to the thousands of Kaiser retirees and other Kaiser creditors, that certiorari should be granted now, without waiting for some additional conflict of decisions to arise. The question of interpreting a single statute with limited legislative history has been presented clearly and straightforwardly in this case, on classic LBO facts, with the relevant factors thoroughly debated, including by the SEC. The means of distributing funds to shareholders of publicly traded corporations is largely uniform and unlikely to be substantially different in future cases. The Tenth Circuit's application of the statute to corporate distributions flowing through that standard network was seriously erroneous; the error has far-reaching consequences which are unjust and widely disruptive; timely review and correction by this Court is called for.

B. Congress Did Not Overrule Centuries of Law in Section 546(e).

"Settlement payment" can connote many things; it is not a term with plain meaning, needing no judicial inquiry to interpret. Disputes are settled, debts are settled, trades are settled, and settlement payments are made. The Bankruptcy Code includes a circular definition of settlement payment; it refers to usage "in the securities trade." 11 U.S.C. § 741(8) (App. K). Interpretation of section 546(e) requires more than merely reading the language of the Code.

1. Settlement payments settle securities trades.

"Settlement" is a word with meaning "in the securities trade"; it is not all-encompassing. Rather, in the numerous industry publications cited by the Tenth Circuit, "settlement" is defined as the completion of a securities transaction, which in turn is defined as a "trade" (App. A at 20A-21A, App. J at 8J-9J). Neither the Bankruptcy Code provision nor a single industry publication which any of the parties has unearthed applies the word "settlement" to one-time mandatory redemptions or cash mergers where corporate assets are distributed to shareholders, rather than a market trade where shares and money are exchanged between buyers and sellers. Moreover, the understanding of settlement payment "in the securities trade" is evidenced by Kaiser's uncontroverted affidavit from a securities industry expert, stating that the "mandatory redemption of Kaiser common stock as part of the leveraged buyout was not a 'settlement payment' as that term is commonly used in the securities trade." Aff. of Richard Teweles, Ph.D., docket No. 46, filed 3-6-89 in Adversary No. 87-E-137, U.S. Bankruptcy Court, District of Colorado.

> Although questions of statutory interpretation are questions of law which are decided by the judge and while a court is not bound by the testimony of witnesses, the trade or com-

> mercial meaning of a term is treated as a fact to be proved in each case.

2A SUTHERLAND STATUTORY CONSTRUCTION § 47.31, pp. 266-67 (5th ed. 1992). That principle was totally ignored by the court in upholding summary judgment for the shareholders here.[3] The Tenth Circuit recognized that it had to "interpret the term 'settlement payment' as it is plainly understood within the securities industry" (App. A at 17A-18A). It then recited trade definitions and legislative history which applied the term exclusively to trading (*id.* at 18A-21A). Then, the court ruled that the term had a broader meaning, without a single citation to any evidence that the securities industry ever used the term outside the context of buying and selling (*id.* at 21A-23A).

In fact, as the court recognized, Congress enacted Section 546(e) based on a securities trading explanation of "settlement payments." It was told that when a customer wishes to buy a security, he gives an order to a broker, who purchases the security from another broker acting on behalf of his own unidentified client, who has entered an order to sell. The respective brokers guarantee that their customers will perform, usually five days later; the clearing agency at the center of the trade also guarantees performance. The clearing agency compares the trade data, clears it, and "settles" the trade by (1) a book entry transfer at the depository, increasing the street name stock account of the buyer's broker and decreasing that of the seller's broker, and (2) debiting the buyer's broker's account and crediting the seller's broker's account - settlement payments. *See, e.g., Hearings,*

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[3] *See Board of Governors, FRS v. Dimension Financial Corp.*, 474 U.S. 361, 373 (1986) (statutory term "commercial loan" did not mean "anything different from its accepted ordinary commercial usage," so Federal Reserve Board extension of term was not a reasonable interpretation); *Louisiana Public Service Comm'n v. FCC*, 476 U.S. 355, 371-72 (1986) (statute should be interpreted "in accordance with the rule of construction that technical terms of art should be interpreted by reference to the trade or industry to which they apply").

Bankruptcy of Commodity and Securities Brokers, Subcommittee on Monopolies and Commercial Law of the House Judiciary Committee on Bankruptcy Amendments Affecting the Securities Industry, September 17, 1981, pp. 243-52; 302-09; 377-81; 491-93 (*"Section 546(e) Hearings"*). The extensive hearing testimony shows that the risks Congress sought to avoid derive from price fluctuations in the market between the time a broker becomes obligated to buy or deliver a security in the open market and the deadline for actual delivery or payment — and the consequences for the facilitators of the sale because of their guarantees. *Id.*

If a bankrupt customer's trustee were able to reverse a trade, or the interim payments that may have been required by a broker upon market price fluctuation before the trade settled, with claims that too much was paid for the shares or they were traded for less than their value, the broker and clearing agency would still be unable to reverse that trade because of their guarantees. Broker liabilities pursuant to guarantees could set off a chain of defaults and insolvencies by the clearing agencies and their other broker members. Section 546(e) was enacted to address those risks. *Section 546(e) Hearings*, pp. 241-67; 302-13; 381-82; 484-86.

Congress' purpose to cover only the risks resulting from the guarantees of trade facilitators is shown by its listing of parties within the statute's scope in section 546(e) itself. All are financial intermediaries processing trades; "equity security holders" are not included in the list, although the term is defined elsewhere. 11 U.S.C. § 101(17). That purpose is also shown by a drafting change in section 546(e); "deposit" had initially accompanied "margin payment" and "settlement payment" as a type of broker or clearing agency transfer that could not be avoided. *Section 546(e) Hearings*, p. 357. It was deleted after securities industry witnesses testified that the term was too ambiguous and could be applied to financial services "not related to traditional securities activities,"

and could prevent avoidance of transfers that have "been recoverable in the past."[4]

2. LBO distributions to shareholders are not section 546(e) settlement payments.

Here, as in *Farrey v. Sanderfoot*, 111 S. Ct. 1825, 1830 (1991), "the text, history, and purpose of § [546(e)] also indicate what the provision is *not* concerned with." Kaiser's LBO merger differed significantly, and in the most material respects, from the trade settlements considered by Congress in enacting section 546(e):

* Payment was made by the corporate treasurer, depleting funds for creditors, rather than one third-party paying another in the market.
* The share surrender and payment were prompted by corporate order; shareholders had no choice to continue holding stock or sell it, once approving the merger.
* The amount to be distributed was pre-established; no clearing agency needed to compare and clear it.
* Shareholders could surrender their old certificates for years after the merger; there was no deadline to turn over shares, or for Kaiser to pay.

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[4] *Section 546(e) Hearings*, pp. 261, 287, quoting SEC Commissioner Bevis Longstreth and Securities Investor Protection Corporation General Counsel Theodore Focht. Mr. Focht cited an example of a transfer avoidance action that should continue to be available in bankruptcy, *Green v. A.G. Edwards & Sons, Inc.*, 582 F.2d 439 (8th Cir. 1978). *Id.* at 287. In *Green*, a buyer of securities transferred additional shares to the seller to secure payment of the purchase price after a sight draft given in payment for the purchase was not honored. The court held the transfer of the additional shares could be recovered as a preference if certain facts were proved. As Mr. Focht said, preventing such a recovery "would not add to the stability of the securities markets . . . a preferential payment which is neither a margin, mark to the market, or settlement payment, nor a deposit to a clearing fund, should continue to be recoverable by a trustee." *Section 546(e) Hearings*, p. 287.

* Critically, Kaiser's payment obligations were pre-funded, as required to de-list stock from an exchange (SEC Reg. § 240.12d2-2), and the certificates had to be returned to Kaiser's agent for review before the money was disbursed; there were no broker or clearing agency guarantees that certificates would be surrendered or that cash would be paid.

* Kaiser's common stock did not even legally exist when it was surrendered or when Kaiser paid its former shareholders. As a matter of law, on the effective date of the merger Kaiser's old stock was converted into the right to receive the cash distribution and preferred stock in the new, surviving corporation. *Shields v. Shields*, 498 A.2d 161, 167 (Del. Ch. 1985); DEL. CODE ANN. tit. 8, § 251(b)(5).

The Tenth Circuit said that Kaiser's shareholders "effectively sold" their shares to the company (App. A at 23A). But in the securities industry, a merger is simply a different animal from a trade, and merger payments are not the settlement payments Congress sought to protect.[5] Congress defined "settlement payment" to include "any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). And as the court below noted, in some respects Kaiser's payments had a similarity to trade payments (App. A at 23A). But they were also "similar" to dividends (mandatory, applicable to all shares, depleting the cor-

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[5] The transaction was not a "sale" as a matter of law either.

> A transaction by which a corporation acquires its own stock from a stockholder for a sum of money is not really a sale. The corporation does not acquire anything of value equivalent to the depletion of its assets . . . It is simply a method of distributing a proportion of the assets to the stockholder. The assets of a corporation are the common pledge of its creditors, and stockholders are not entitled to receive any part of them unless creditors are paid in full. When such a transaction is had, regardless of the good faith of the parties, it is essential to its validity that there be sufficient surplus to retire the stock without prejudice to creditors.

Lippi at 31, quoting *McConnell v. Estate of Butler*, 402 F.2d 362, 366 (9th Cir.1968) and *Robinson v.Wangemann*, 75 F.2d 756 (5th Cir. 1935).

porate treasury, a set dollar amount, and disbursed through the same accounts used to account for and settle stock transfers). The critical similarity is to dividends, not trades, because clearing agencies and brokers do not guarantee that a corporate issuer will pay dividends or cash merger payments or any other corporate-dictated, rather than trade-dictated, payment. They do not guarantee that the money will be disbursed, or that it never will be recovered if the corporate issuer is insolvent.[6]

The corporate distributions not guaranteed by brokers and depositories are not even called "settlement payments" in the securities trade, even though they are disbursed through the same accounts and counted in the daily reckoning of clearing agency account balances. Depository clearing agencies facilitate dividends, cash exchanges upon a merger, and stock redemption payments, which have nothing to do with the comparison/clearance/settlement process, as well as facilitating trades which do turn on that process. These corporate distributions are considered "post-settlement services" or the "processing of a corporate action."[7]

The object and policy of section 546(e) was to reduce the risk of a chain of bankruptcies by securities trade facilitators, not to block recoveries of improper corporate distributions from

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[6] "Similarity" should be judged by the object and policy of the statute. *Massachusetts v. Morash*, 490 U.S. 107, 114-19 (1989) (ERISA term interpreted not to include vacation time in the absence of any indication "that Congress intended such far-reaching consequences"); *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) (*noscitur a sociis* "wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress"; term "discovery" in Internal Revenue Code section held to relate only to discovery of mineral resources and not drugs).

[7] *Clearance and Settlement Systems in the World's Securities Markets*, GROUP OF THIRTY, New York and London (March 1989) at 13, 51, 53, 59. The depository clearing agency handling over $98 million of the Kaiser distribution did not term its credit of Kaiser money to its brokers' accounts a settlement, but rather a "cash dividend adjustment-cash merger at $22."

shareholders. The SEC Commissioner had described the legislation to Congress as "technical, clarifying and minor amendments to the Code . . . which relate to the problems of the securities industry addressed above." *Section 546(e) Hearings* at 260. If Congress had intended a radical departure from the common law, federal statutory law, and the law of every state, it would have expressed its purpose far more clearly than can be found in the language and legislative history of section 546(e).

3. Other Code provisions and court rulings do not support the decision below, as claimed.

The court below thought "settlement payments" should be broadly construed because the Third Circuit said so in *Bevill, Bresler & Schulman v. Spencer Savings & Loan*, 878 F.2d 742, 750-51 (3d Cir. 1989), a case that held "[p]roper judicial construction [of section 546(e)] . . . requires recognition and implementation of the underlying legislative purpose . . . lest a court make a construction within the statute's letter, but beyond its intent." But the Tenth Circuit erroneously considered the repurchase agreements at issue in *Bevill, Bresler* not to be trades (App. A at 22A-23A). In fact, repurchase agreements are "nothing more than contracts for purchase and sale of securities" although in some respects they are also like secured loans. *In re Bevill, Bresler & Schulman Asset Management Corp.*, 896 F.2d 54, 55 (3d Cir. 1990). Repurchase agreements do not involve distribution of corporate assets by the corporation, but the trading of such assets by third parties in contexts where settlement payments are made. Until the Kaiser decisions, the definition of settlement payment and the scope of section 546(e) had never been extended beyond the trading of securities.

The Tenth Circuit also reasoned that settlement payments encompass more than buying and selling of securities because Congress referenced "securities contracts" in section 362(b)(6), a provision excepting the setoff of mutual debts in connection with securities contracts from the bankruptcy automatic stay, and did

not reference that term in section 546(e) (App. A at 21A; App. K). There is no basis to support that theory; a more compelling inference is that settlement payment is a narrow term covering only purchases and sales, and that Congress had to reference securities contracts in the stay exception to make it cover other types of securities transactions. "Securities contract" is defined in section 741(7) to include not only a contract for the sale of a security, but also an option and a contract for a "loan of a security" (App. K). Section 362(b)(6) was enacted so brokers and clearing agencies could exercise their contract rights to close out accounts under outstanding securities contracts upon a customer bankruptcy. *Section 546(e) Hearings* at 208-13, 241, 258, 314-15, 382, 388. In a fluctuating market, prompt action may be critical to avoid substantial losses pursuant to broker guarantee liability. The bankrupt customer's obligation to make settlement payments or right to receive settlement payments needs to be offset against other obligations and other cash and securities held by the broker. Further, obligations under contracts for the loan of securities and rights to recover loaned securities or keep cash collateralizing a securities loan must be included in the overall closing of the bankrupt customer's account.

The exception to the stay for setoffs in section 362(b)(6) references "securities contracts" as well as "settlement payments" because it is intended to apply to more than settlement payments.

4. Congress cannot be deemed to have inadvertently reversed fundamental law.

This Court has repeatedly expressed its reluctance

> to accept arguments that would interpret the [Bankruptcy] Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.

Dewsnup v. Timm, 112 S. Ct. 773, 779 (1992), citing several recent cases of this Court interpreting Bankruptcy Code provisions which, like section 546(e), were not entirely clear on their face.

Here, the Tenth Circuit effected not just a major change, but a monumental change, in pre-Code practice. The legislative history of section 546(e) is unlike that of some other Code provisions, where Congress simply cited a few examples to illustrate the statute's operation, clearly never expected to be exhaustive, and used broad statutory language. Rather, section 546(e) expressly defines settlement payments as "commonly used in the securities trade" — where settlement payments settle share trading — and the history confirms it was enacted to answer a specific concern having nothing to do with the long-standing ability of creditors to recover distributions by insolvent corporations to their shareholders.

The change from pre-Code law is monumental because it is an inescapable fact that much of the stock of publicly owned companies is held by brokers in street name; payments to public shareholders have to be routed through them.[8] It is also anomalous, because creditors can recover fraudulent conveyances from shareholders outside of bankruptcy, unhampered by Code section 546(e), in a class action or a multiplicity of suits. But neither a company seeking to reorganize, nor a company so dismembered that it must liquidate, can recover the same claims to distribute fairly for the benefit of all creditors.

Moreover, the Tenth Circuit's interpretation of section 546(e) appears to shield automatically the architects of and active participants in an LBO. This interpretation gives every financial in-

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[8] No statute or rule or regulation prohibits brokers from holding even the stock of small, closely held companies in street name, as agents for their customers. If such a practice will insulate the customer beneficial shareowners from fraudulent conveyance, preference and other liabilities, the practice will certainly become even more widespread.

stitution, stockbroker, and even private investor, regardless of knowledge, involvement or interest, the license to buy up stock of an insolvent corporation for its own account when getting wind of a proposed LBO, secure in the knowledge that it is protected from the operation of fraudulent conveyance laws unless actual, intentional fraud is proved, an extremely high burden, and the dealmakers did not manage to structure the LBO to enable the company to last at least one year. [9]

II. The Public Importance Of This Question Warrants Review At This Time.

The public importance of the question presented is demonstrated from two perspectives, the first the microcosm of the particular case, and the second the macrocosm of the rise of this very significant issue in the American economy.

A. The Dire and Unjust Consequences of the Kaiser LBO Need to be Redressed.

Kaiser's shareholders, many of whom bought into the action to make an LBO profit, paid themselves handsomely at the expense of the steelworker retirees and other Kaiser creditors. Kaiser had promised its employees lifetime medical care, and many relied on that promise until it was too late to obtain other affordable coverage. Then Kaiser had to eviscerate the retirees' medical benefits, within months of the LBO, just to keep operating and pay the LBO debt and other obligations.

There are still over 7,000 Kaiser retirees, most of whom have dependents, counting on the medical and pension trusts established under Kaiser's reorganization plan for their very survival.

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[9] Section 546(e) allows only one type of settlement payment to be set aside: a payment within the scope of Code section 548(a)(1), which deals with transfers made with actual intent to hinder, delay or defraud, within one year of bankruptcy. 11 U.S.C. § 546(e).

When they lose these benefits, especially the medical benefits, many will be financially devastated by the medical problems that result from a lifetime of work in the mines and mills. Continuance of retiree medical care hinges on litigation recoveries. Kaiser's shareholders gambled that the LBO would not exceed the limits of fraudulent conveyance law, a gamble with the retirees' and creditors' money. The fundamental policy that creditors come before shareholders should not be circumvented by an unwarranted extension of section 546(e) beyond Congress' intent.

B. The Kaiser Phenomenon Is Only the Beginning.

We do not ask the Court to review the whole subject of LBOs. There have been successes and there have been failures; there have been abuses. *Cf. CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 92 n.13 (1987). All we ask is that where there is an abuse which leads to bankruptcy, the trustee must not be cut off, by a serious misinterpretation of the Bankruptcy Code, from his most effective remedy.

1. LBOs have created widespread opportunities for other bankruptcies comparable to Kaiser's.

Careful studies have shown that especially in the last half of the 1980s, LBO activity increased, with increasing premiums, increasing debt, and declining performance in marginal transactions. [10] The sheer numbers are astounding. Estimates range as high as $500 billion paid to shareholders in highly leveraged mergers and defensive moves to avoid corporate raiders. Debt to equity ratios

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[10] *E.g.*, Long and Ravenscraft, *Decade of Debt: Lessons From LBOs in the 1980s*, BROOKINGS INSTITUTE No. 91-6 (October 1991), pp. 13, 22, 24; *Leveraged Buy Outs and the Pot of Gold: 1989 Update*, a Report for the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, U.S. House of Representatives, p. 7 (July 1989) ("1989 Congressional Report"); *see also* Kaplan and Stein, *The Evolution of Buyout Pricing and Financial Structure in the 1980s*, Working Paper 1992 (University of Chicago and MIT) ("Kaplan and Stein").

grew to 100:1, and multibillion-dollar blind pools of junk bonds were formed to finance some LBOs before the deals were even named.[11]

The shareholders of LBO target companies often received substantial premiums for their stock. While in mergers of earlier years a bidder might pay 20% over market for a target company, in the contested takeovers of the 1980s, the premiums consistently averaged 80%. And in some of the largest acquisitions, such as RJR Nabisco and Kraft, the premiums were almost 100%.[12] Virtually every empirical study has found that share prices increase significantly upon announcement of a takeover attempt. Roll, *Empirical Evidence on Takeover Activity and Shareholder Wealth*, in KNIGHTS, RAIDERS, AND TARGETS, p. 241 (Coffee, Lowenstein, Rose-Ackerman eds.) (1988).

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[11] Faltermayer, *The Deal Decade: Verdict on the '80s*, FORTUNE, August 26, 1991 (hereafter "FORTUNE"), p. 61, citing Sikora, editor of MERGERS & ACQUISITIONS. The 1989 Congressional Report concluded that in the five-year period from 1984 to the end of 1988, total completed LBO transactions amounted to $157.1 billion, without counting the $24.8 billion RJR Nabisco transaction that closed early the following year. 1989 Congressional Report at 5. Lowenstein, *Short-term Gain and the Absentee Shareholder*, WHAT'S WRONG WITH WALL STREET at 146 (1988) ("WHAT'S WRONG"); FORTUNE, id.; 1989 Congressional Report, p. 107. Junk bonds are issues whose creditworthiness is either unrated or rated below investment grade by the major rating agencies, due to their greater risk of default. To induce investment in such bonds, the interest or yield is high.

[12] Lowenstein, SENSE & NONSENSE IN CORPORATE FINANCE, p. 26 (1991) ("SENSE & NONSENSE"). TWA stock traded on the open market at $8 a share before Icahn began investing; his takeover was completed at $24 per share, Shleifer and Summers, *Breach of Trust in Hostile Takeovers*, p. 49, article in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES (Auerbach ed.) (1988). Where the number of competing bids was three or more, the median premium over the pre-announcement stock prices was 76%. Lowenstein, *No More Cozy Management Buy Outs*, HARVARD BUSINESS REVIEW, January-February 1986, p. 149.

The vast premiums paid to shareholders were funded by massive debt. In 1980s leveraged deals, the debt typically ran as high as 90% of capitalization. By the summer of 1990, the LBO bank debt of the 1980s was estimated to be $350 to $400 billion. [13] But the total debt was much more, and much riskier; there were $210 billion face value of public-issue junk bonds outstanding, representing one-fifth of all corporate bonds, and another $50 to $200 billion low-grade debt issued privately to banks and insurers. [14]

The debt in some cases could not possibly be paid. To close the deals and collect the fees, investment bankers devised zero-coupon, pay-in-kind and similar forms of debt; these provided the immediate moratorium on junk financing payments necessary for the transactions not to be in default upon closing. The senior bank debt usually required repayment on tight schedules, however. LBOs were structured with some liquidity reserves and means to pay the senior banks, including from junk bonds and asset sales — taking the companies past the one-year period in which even an intentional fraud suit could be brought under the Tenth Circuit's view of Section 546(e) — but when funds run out, with cash and assets reduced, the LBO debt default rate is significant. [15]

Some LBO-burdened companies have slipped into bankruptcy, including such formerly substantial companies as Revco, Fruehauf, Dart Drugs and Macy's. More are yet to come. One study of 83 LBO deals put together between 1985 and 1989 found

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[13] FORTUNE, pp. 62, 78. According to the 1989 Congressional Report, commercial banks' total LBO loans made through September 1988 amounted to $563.8 billion. 1989 Congressional Report at 18.

[14] SENSE & NONSENSE, p. 75. The 1989 Congressional Report concluded that the amount of America's corporate debt has increased substantially, and the quality of debt has deteriorated markedly. 1989 Congressional Report at 199.

[15] SENSE & NONSENSE, p. 78; FORTUNE p. 62; 1989 Congressional Report pp. 7, 24, 30-34; WHAT'S WRONG, p. 146; Wigmore, *The Decline and Credit Quality of New-Issue Junk Bonds*, FINANCIAL ANALYSTS JOURNAL, September-October 1990 at 53, 59-62.

a default rate of 27% and nine bankruptcies as of August 1991; it concluded the numbers understate the proportion of eventual problems. Kaplan and Stein, p. 1. A Fortune "health check" of companies on its "deals of the year" lists between 1985 and 1990 evaluated their progress in rebuilding financial strength after taking on colossal debt in highly leveraged mergers or defensive moves. Fortune found that more than half "show[ed] no advancement or have slipped deeper into the hole." [16] About 17%, or $40 billion, of the publicly trade junk bonds are currently in default, and another $50 billion are expected to default in the next few years as trigger events such as principal repayments and payment in kind securities cash payments are required to begin. FORTUNE, pp. 65, 68. Some of these companies will have fraudulent conveyance claims like Kaiser's.

2. The plight of Kaiser's steelworkers and miners is by no means unique.

The substantial distributions to shareholders in the excessive LBOs cost more than the obligation to repay debt. There are human costs as well. As one study phrased it, "hostile takeovers thus enable shareholders to redistribute wealth from stakeholders to themselves." Shleifer and Summers, *supra*, p. 41. The stakeholders involuntarily transferring the wealth are employees with implicit contracts for wages, and medical and retirement benefits. The data on layoffs and pay reductions is anecdotal with no hard numbers available; but clearly LBO debt must be paid, and in some instances plants are sold and closed, wages are cut, employees are laid off and forced into early retirement to help make cash available. 1989 Congressional Report, pp. 18, 180-84; *Statements on Job Impact of Corporate Takeovers Before Senate Banking Subcommittee on Securities*, April 9, 1987. Layoffs and

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[16] FORTUNE, p. 64. The 1989 Congressional Report cited a number of experts opining that highly leveraged firms are less resilient to economic downturns and likely to file bankruptcy or undergo workouts. 1989 Congressional Report at 205-10.

company inability to pay promised benefits due to strapped financial conditions mean stakeholders lose while shareholders gain. [17]

Congress has recognized the substantial impact of bankruptcy cases on retirees, and the need to protect retirees' health benefits upon company bankruptcies, enacting the Retiree Benefits Protection Act in 1988. 11 U.S.C. § 1114. That act did not solve the problem, however, or alleviate the need to fund retirement costs as well as other creditor losses by recovering the excessive monies distributed to shareholders. [18] A 1991 General Accounting Office study showed that despite the act, nearly half of the surveyed companies terminated retiree health benefits after filing for bankruptcy. GAO, *Employee Benefits, Effect of Bankruptcy on Retiree Health Benefits*, GAO/HRD-91-115 (August 1991).

Trusts for retiree medical benefits are created in some bankruptcy reorganizations, as in the Kaiser case. But those trusts only partially finance health coverage for retirees and their dependents until the funds are exhausted, sometimes within a few years, leaving retirees responsible for the cost of their health

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[17] Unsecured creditors of an LBO-impaired company lose as well. Bondholders, for example, find the market value of the bonds they bought drop substantially when rating agencies evaluate the risk of their formerly sound companies being much less able to pay their debts. Graml, *Bondholder Rights in Leveraged Buyouts in the Aftermath of Metropolitan Life Ins. Co. v. RJR Nabisco, Inc.*, 29 AM. BUS. L.J. 1 (1991); Farrell, *Takeovers and Buyouts Clobber Blue-Chip Bondholders*, BUSINESS WEEK, Nov. 11, 1985, p. 113.

[18] Retiree benefits may be modified or terminated in bankruptcy if the company reserved that right, *In re Doskocil Cos. Inc.*, 130 B.R. 870 (Bankr. D. Kan. 1991); must be paid only if there are unencumbered funds available, a rarity in any Chapter 11, *In re Jones & Lamson Machine Co., Inc.*, 102 B.R. 12 (Bankr. D. Conn. 1989); may be modified under a plan, *Matter of Federated Department Stores, Inc.*, 132 B.R. 572 (Bankr. S.D. Ohio 1991); and may be modified and reduced simply because the debtor has insufficient funds, *In re GF Corp.*, 115 B.R. 579 (Bankr. N.D. Ohio 1990).

coverage thereafter. GAO Study, p. 5. The money to fund such trusts for bankrupt, LBO-impaired companies is at issue here.[19]

3. The Tenth Circuit's decision opens the door to massive defeat of creditors' rights through creative statutory interpretation.

The shareholders receiving premiums of 80% over market in the 1980s LBOs were not, by and large, individuals with a few share certificates in a safety deposit box. The Kaiser defendant list is not an aberration. "Arbitrageurs have played a key role in takeovers by buying shares from investors to build blocks in takeover targets. Often these blocks have been sold on to the corporate raiders. This is a legitimate business as long as the arbitrageurs do not act on insider information or work in collusion with the raiders." [20] The increasing prices of stocks in play are not accidental; the market is stimulated by speculative operators seeking to reap huge arbitrage profits. WHAT'S WRONG, pp. 124, 161, 171. Large Wall Street firms with capital to invest, knowledge of companies looking for or vulnerable to takeovers and lucrative short-term opportunities, have been unwilling to let them pass by untapped.[21] Even were the 1980s LBOs abuses never to recur, the

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[19] Pension funding is another casualty of bankruptcy. Some, but not all, retirees have pension claims that are federally insured. While this provides at least some protection upon a bankruptcy filing, it imposes a significant financial burden on the PBGC. The PBGC's bankruptcy-related funding problems are significant, and are exacerbated when the agency cannot receive its share of legitimate lawsuit recoveries.

[20] Oram, *Wall Street Takes On The Triple Alliance; The Boesky Scandal*, FINANCIAL TIMES, November 20, 1986; *see also* Richter, *Arbitrage Firms Smarting From Long Bout of Charges*, LOS ANGELES TIMES, Nov. 3, 1988 § 4, p. 1; Cohen, *Bigger Money, Bigger Risks*, 139 BANKER(UK) 28, 30 (Jan. 1989).

[21] Sterngold, *Wall Street Buys Into the Action*, NEW YORK TIMES, June 19, 1986, § D p. 1. To the extent not held by arbitrageurs, corporate stocks are held largely by institutional investors. Institutions own about 45% of all corporate equities outstanding, including 80% or more of the shares of some companies. 1989 Congressional Report, pp. 9, 129; SENSE & NONSENSE, p. 210.

bankruptcies arising from them and the vast dollars funneled to shareholders in unsound LBOs at the expense of stakeholders, creditors, and the PBGC, warrant consideration of section 546(e) before its impact widens.

4. Unless the Tenth Circuit decision is reversed now, litigation costs will inflict further injury on retirees and other creditors.

The cost of litigation can exhaust a significant part of a bankruptcy estate, and the time involved in pursuing legitimate claims can result in a significant deterioration of a debtor's business. Blassberg and Vasily, *Tightening the Noose on Fraudulent Conveyance*, 26 MERGERS & ACQUISITIONS at 47 (November/December 1991). A debtor or trustee has alternatives of pursuing the shareholders who benefitted directly and immediately from the additional debt by cashing out in the LBO, where the consideration returned to the debtor is almost unquestionably worth less than the cash received, and the only real issue to be proved is insolvency or inadequate capitalization post-LBO. Or, he can limit litigation to more difficult causes of action quite unlikely to generate even close to an equivalent recovery: Suits against officers and directors, facing the business judgment defense and insurance coverage issues; suits against professionals and advisors, requiring not only proof that the debtor's damaged financial condition was caused by their advice, but generally also proof of negligence and malpractice, with any recovery possibly reduced on comparative negligence grounds; or suits against LBO lender banks who actually did contribute cash to the deal, where courts have directed cancellation or subordination of any outstanding indebtedness, but rarely, if ever, cash to pay creditors.

The *Kaiser* decision increases the litigation cost in suits against shareholders, and adversely skews the settlement negotiations. [22]

The increased cost and risk and reduction of monies available to fund retiree trusts is clear and immediate for Kaiser's creditors and retirees. The Tenth Circuit concluded its decision with the point that Kaiser could still sue specific individuals or institutions for unlawful acts (App. A at 26A). Kaiser has done so, pursuing and settling various claims, including one with the officers and directors who held a $25 million insurance policy that decreased with each dollar spent by defense counsel, for $17 million. The retiree medical trust has already exhausted all the net litigation proceeds it has received to date, on benefits payments costing about $400,000 a month.[23] Kaiser is still pursuing claims against accountants and an investment banker, but recognizes that comparative negligence statutes and judgment reduction requirements of the directors and officers' settlement may well reduce any collection from them. Kaiser has claims against the Jacobs Group, including a $14 million "greenmail" claim; $33 million of its claims against the Jacobs Group are for monies distributed for their shares, however.

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[22] The court-appointed independent examiner in the *Revco* bankruptcy explained to the *Revco* bankruptcy court that: "Although 'settlement payment' may be a broadly defined term, the Kaiser approach appears to go beyond the normal usage of that term, and section 546(e) only provides an exemption for settlement payments to certain types of recipients. Payments to selling shareholders in a leveraged buyout are likely not the type of payment envisioned by Congress as 'settlement payments'. . . . Indeed, legitimate arguments run counter to the Tenth Circuit decision . . . The Kaiser decision does, however, certainly detract from the benefits of such litigation by providing an additional hurdle." *Final Report of Examiner Professor Barry Lewis Zaretsky*, Dec. 17, 1990, at 235-237 in *Revco, supra*, p. 11. The *Revco* claims were released before a single motion was heard.

[23] The trust is selling its stock in reorganized Kaiser to meet its obligations, when it can. SEC rules restrict the amount it can sell and sales timing, and prohibit any sales when Kaiser has inside information about events financially affecting the company, until public disclosures are made.

Kaiser's claim to recover from eminently solvent former shareholders, including only those who held large amounts of stock as beneficial shareholders, seeks roughly $100 million not subject to comparative negligence or judgment reduction. These monies would significantly assist in paying the $500 million retiree medical claims, $200 million PBGC claim, and $250 to $500 million of other unsecured creditor claims. A recovery against the shareholders who benefitted the most by the LBO would add years of benefits to the retiree medical benefits and pension trust funds. There is no good reason to wait for the decision of the court of appeals of another circuit, since otherwise thousands upon thousands of Kaiser retirees and creditors will be irreparably harmed. If this Court does not grant certiorari, people who worked in dirty and dangerous jobs for Kaiser for 30 years and more, and widows whose husbands died in the mines and mills, will lack the money needed to make their last years tolerable; they and other creditors will be deprived of what is justly due them while the arbitrageurs will keep their millions of dollars to invest again, free from concern for the human casualties of risky ventures.

CONCLUSION

The decision below conflicts with the general law which has long recognized that creditors come before shareholders. The Tenth Circuit's novel interpretation of the Bankruptcy Code is not only seriously in error, but is fundamentally harsh and unjust. The public importance of this question is, in any event, so large that the petition should be granted.

RESPECTFULLY SUBMITTED, March 1992.

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APPENDIX A

APPENDIX A

PUBLISH

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

IN RE: KAISER STEEL CORPORATION,	)	
	)	
Debtor.	)	
	)	
	)	
KAISER STEEL CORPORATION; KAISER STEEL RESOURCES, INC., formerly known as Kaiser Steel Corporation,	)	
	)	
	)	
Plaintiffs-Appellants,	)	Case No. 90-1243
v.	)	
	)	
PEARL BREWING COMPANY; FALSTAFF BREWING COMPANY; OPPENHEIMER & CO. INC.; JOSEPHTHAL & Co., Josephthal & Co. Incorporated; THE HILLMAN Co., INDIVIDUALLY AND AS TRUSTEE FOR THE N.M.U. PENSION TRUST; HERZFELD & STERN; HERZFELD & STERN INC. , now known as JII Securities, Inc.; GOLDMAN SACHS & Co.; A.G. BECKER PARIBES INC., now known as Merrill Lynch Money Market, Inc.; A.G. EDWARDS & SONS, INC.; ALPINE ASSOCIATES; ASIEL & Co.; BANKERS TRUST COMPANY; BARCLAY'S BANK INTERNATIONAL LIMITED; BEAR STEARNS & Co., individually and as custodian for the IRA ACCOUNT OF	)	

ROBERT W. SABES; BRADFORD TRUST CO.; COWEN & CO.; CROCKER NATIONAL BANK; DAIN BOSWORTH, INC.; DILLON READ & CO., INC., individually and as General Partner of B/DR ARBITRAGE FUND LIMITED PARTNERSHIP; DOFT & CO., INC.; DREXEL BURNHAM LAMBERT, INC.; EASTON & CO.; EDWARD A. VINER & CO., INC., now known as Fahnestock & Co.; EDWARD D. JONES & CO.; ENGLER & BUDD COMPANY; EPPLER, GUERIN & TURNER, INC.; ERNST & COMPANY; EVANS & CO., INC.; FIFTH THIRD BANK; FIRST KENTUCKY TRUST COMPANY; HERZOG, HEINE, GEDULD, INC. ; HUNTINGTON NATIONAL BANK; KELLNER, DILEO & CO.; KIDDER, PEABODY & CO.; L.F. ROTHSCHILD UNTERBERG, TOWBIN, now known as L.F. Rothschild & Co., Inc.; LAFER AMSTAR & CO., now known as Amstar & Co.; LAIDLAW ADAMS & PECK, INC.; MANLEY, BENNETT, MCDONALD & CO.; MANUFACTURERS NATIONAL BANK OF DETROIT, individually and as Trustee for MANUFACTURERS EXTENDED INDEX FUND; MARCUS SCHLOSS & CO., INC.; MARINE MIDLAND BANK, N.A.; MARINE MIDLAND BANK; MOORE & SCHLEY, CAMERON & CO.; MORGAN GUARANTY TRUST COMPANY; MORGAN, OLMSTEAD, KENNEDY & GARDNER, INC., now known as Wedbush Morgan Securities; NEWHARD, COOK & CO., INCORPORATED; OSCAR GRUSS & SON, INC.; PAINE, WEBBER, JACKSON & CURTIS, INC., now known as Paine Webber, Incorporated; Q & R CLEARING CORPORATION; R.L. TUCKER, ANTHONY & DAY, INC., also known as Anthony Tucker & R.L. Day, Inc.; REGIONAL CLEARING CORP.; S.B. LEWIS & CO.; SANFORD C. BERNSTEIN & CO., INC.; SECURITIES SETTLEMENT CORP.; SHAWMUT BANK OF BOSTON, N.A.; SLK-SEG; SMITH, BARNEY, HARRIS, UPHAM &

Co., Inc.; Southwest Securities, Inc.; SSB-Custodian, also known as State Street Bank and Trust Co., Individually and as Trustee for American Telegraph and Telephone Pension Fund; Sutro & Co., Inc.; Swiss American Securities, Inc.; Swiss Bank Corporation; Thomson McKinnon Securities, Inc.; United States Trust Company of New York; Walwyn Stodgell Cochran Murray, Limited; Weedbrush, Noble & Cooke, Inc., now known as Wedbush Morgan Securities; Wells Fargo Bank, N.A.; Baily Gordon Securities, now known as Gordon Capital; First Arbitrage Partnership, now known as Brenzel Birkenshaw Capital, Inc., American National Bank and Trust Company of Chicago; Alan Bush, now known as J.W. Charles Bush, Securities Inc.; K.J. Brown & Co., Inc.; Millikin National Bank of Decatur; O'Connor Securities; Stephens, Inc., now known as Stephens Group, Inc.; Larkin & Co.; SAIC/SNY; Somers Grove; and The First Boston Corporation,

Defendants-Appellees,

and

Securities Exchange Commission,

Appellees,

and

Advest, Inc.; Atlantic Capital Corp., now known as Deutsche Bank Capital Corp.; Bank of

MONTREAL; BANK OF NEW ENGLAND, N.A.; BROWN BROTHERS HARRIMAN & CO.; CHEMICAL BANK; DEAN WITTER REYNOLDS, INC.; FAHNESTOCK & CO.; FIRST ALBANY CORP.; JEFFERIES & COMPANY, INC.; KALB, VOORHIS & CO.; LEWCO SECURITIES CORP.; MABON, NUGENT & CO.; MANUFACTURERS & TRADERS TRUST CO.; MERRILL, LYNCH, PIERCE, FENNER AND SMITH, INC.; MCLEOD YOUNG WEIR, LIMITED; NATIONAL FINANCIAL SERVICES CORP.; PACIFIC BROKERAGE SERVICES; PIPER JAFFRAY & HOPWOOD, INC.; SPEAR LEEDS & KELLOGG; TWEEDY BROWNE CLEARING CORP.; BURKE CHRISTENSEN & LEWIS SECURITIES, INC.; CONTINENTAL BANK; I.M. SIMON & CO.; EMETTE LARKIN & CO.,

Defendants.

KAISER STEEL RESOURCES, INC., formerly known as Kaiser Steel Corporation,

Plaintiff-Appellant,

v.

Case No. 90-1245

ACTION TRADERS, INC., now known as ATI Corporation; JOHN A. ALDEN, M.D., & ANN ALDEN; ALTONA HOLDINGS, LTD.; AMERICAN FLETCHER BANK SUISSE, now known as Merrill Lynch International Bank (Suisse), S.A.; HERBERT M. AMES; LILLIAN AMES; ROBERT STABLER, individually and as trustee for the Amesbury Fund; W.H. & S.C. AMESBURY, INDIVIDUALLY AND AS TRUSTEES FOR U/W/O JANE WINTON & F/B/0 SCOTT WINTON;

WILLIAM H. AMESBURY; ARSHOT INVESTMENT CORPORATION; BANK OPPENHEIM PIERSON; IRA ACCOUNT OF ROBERT W. SABES, AND ROBERT W. SABES, INDIVIDUALLY; LYLE A. BERMAN; JANIS R. BERMAN; JOHN C. BONDURANT; DORIS BONDURANT; BUILDING SERVICE EMPLOYEES RETIREMENT PENSION FUND LOCAL 32E, AFL-CIO TN UA 06/15/55 AND ITS TRUSTEE; BROADWAY REALTY CO.; BULLET BAY INTERNATIONAL CO. N.V.; BARBARA BARRETT BUSBY, individually and as trustee FBO BARBARA B. BUSBY REVOCABLE TRUST UTD DTD; CASCADE FUND, a limited partnership; WILFRED CLEGG; VERA CLEGG, individually and as co-trustees for the CLEGG FAMILY TRUST UDT DTD 5/14/71; COLLEGE RETIREMENT EQUITIES FUND; THOMAS CONWAY; JUDITH ANN COTTON; SUMNER COTTON; CURTIS ASSOCIATES, INC., individually and as trustee for the PENSION TRUST and the RETIREMENT TRUST; ALAN CURTIS, individually and as trustee for the PENSION TRUST and the RETIREMENT TRUST; ALAN CURTIS, individually and as trustee for the ALAN TRUST and the CURTIS TRUST; DAPER REALTY INC.; DECISIONS, INC.; DELBRUECK & CO.; B/DR ARBITRAGE FUND LIMITED PARTNERSHIP AND BESSEMER SECURITIES CORPORATION AS ITS LIMITED PARTNER; ELISABETH H. DOFT; ALAN DOFT; E.F. BRADY COMPANY; EASTON & CO.; A.G. ELLIS; JACQUELYN ESCO; WELLS FARGO BANK, individually and as trustee of EXXON CORP. ANNUITY TRUST FUND; MARY FULLERTON FARR; FEMIROL OVERSEAS S.A.; WILLIAM BARRY FURLONG; ISABEL FURLONG; G S C OF NEVADA, INC.; CHARLES R. GESME; HENRY GOODE; GOODE-ADEL PARTNERSHIP; SAM V. GORDON; ANITA V. GORDON; SAM V. GORDON, doing business as Gordon

Enterprises; SHELDON I. GREENBERG; GORDEN)
GRENDER; BANKERS TRUST, individually and as)
Trustee for GTE SERVICE CORP., also known as GTE)
High Yield Account; HAMBROS BANK, LTD.; JACOB)
HARRIS, M.C., P.C. DEFINED BENEFIT PENSION TRUST)
AND ITS TRUSTEE; WARREN HARRISON; DORIS)
GRUNWALD; KARIN HEINE; PEGGY HEINE,)
co-executrixes of the ESTATE OF MAX L. HEINE and)
ESTATE OF CHARLOTTE HEINE; HERMAN WILSON)
LUMBER COMPANY; JOSEPH INY; MRS. JOSEPH INY;)
RICHARD O. JACOBSON; SARAH T. JACOBSON; PAUL)
JACOBSON; DEBORAH F. COOPER; LILLIAN GIBSON;)
PAUL SCHRYVER, as successor trustees to EVE B.)
JARVIS as trustee UA 07/01/64 Airlie Trust; PAUL G.)
JENDE; ARLENE M. JENDE; CLARA KELLNER; GEORGE)
A. KELLNER; JOHN DOE TRUSTEE, individually and as)
trustee for the KEYSTONE AGGRESSIVE STOCK TRUST;)
INDIVIDUALLY AND AS TRUSTEE POR THE KEYSTONE)
CUSTODIAN FUND S-4; KINSDALE PARTNERS; SIDNEY)
KISIN; EDMUND KLEIN; NORMA KLEIN; EZRA)
KOTCHER; DOROTHY KOTCHER; W. DONALD LARSON;)
FRANCIS W. LAWRENCE, individually and as trustee for)
U/A D.T.D. 12/30/81, DERALD H. RUTTENBERG)
CHARITABLE LEAD ANNUITY TRUST; LES FILS)
DREYFUS & CIE S.A.; HUGH T. LINDSAY; MRS. HUGH)
T. LINDSAY; JAMES K. LINDSAY; MRS. JAMES K.)
LINDSAY; M. H. DAVIDSON & CO.; MAERKI BAUMANN)
& CO., A.G.; LEO MAINEMER; ESTER MAINEMER;)
ELLIOT MARPLE; BARBARA K. MARPLE; WILBERT K.)
MARTIN; ELIZABETH M. MARTIN; IVOR MASSEY, JR.;)
JANE DOE MASSEY; JOHN B. MCDONALD; ELAINE)
MCKELVEY; ROBERT D. MCLEAN; MRS. ROBERT D.)
MCLEAN; MERCURY SECURITIES, INC.; MIDLAND BANK)
PRINCESS STREET, NOMINEES LIMITED; MOSELEY,)

HAUGARTEN, ESTABROOK & WEEDEN, INC., also known as Mosely Securities; MOUNT SINAI MEDICAL CENTER, INC.; MOUSSARD S.A.; MICHAEL MULLER; ELKE M. MULLER; NERVAL & MANOR; NUMBER SEVEN ACCOUNT, and its Trustee (029-24-9996); T 98 ARB 1980, Account #000-01198 with OSCAR GRUSS & SONS, INC.; JOHN D. PICCHETTI; MARGARET M. PICCHETTI; PICCHETTI, INC.; AL I. POLLACK; BEVERLY POLLACK; R.P. RICHARDS, INC.; RESEARCH CHARITABLE TRUST, and its TRUSTEE; R. J. SCHEUER & CO.; E. FRANKLIN ROBBINS & JANE DOE ROBBINS; ROBERT FLEMING, INC., now known as Flemings North America Inc.; ROYAL BANK OF SCOTLAND PLC, as trustee for RBOS-TTUTS ALL SUN AMER SPEC; ROYAL BANK OF SCOTLAND PLC, as trustee for RBOS-TT-UTS ALL DUN INTL FUND; ROYAL BANK OF SCOTTSDALE PLC, as trustee for RBOS TT UTS ALL DUN INTL FUND; ROYAL BANK OF SCOTLAND PLC, as trustee for RBOS-TT-UTS ALL DUN SEC AMR TR; ROYAL INVESTMENT COMPANY; S. PAUL POSNER & CO.; SALTZMAN PARTNERS; SAN FRANCISCO MUSEUM OF MODERN ART; GENE L. SCHUMACHER; MRS. GENE L. SCHUMACHER; SEQUOIA INS. CORP.; MARJORIE SHAMGOCHIAN AND THE ESTATE OF HERONT SHAMGOCHIAN; J.R. SIMPLOT; ESTHER SIMPLOT; SOBERANO OCEANICO; MARY AMESBURY STABLER; ROBERT C. STABLER; ROBERT C. STABLER, individually and as trustee U/A/D F/B/O L. Stabler; JOHN STAVICK; STE JEANES CORPORATION; JACKSON T. STEPHENS; MARY ANNE STEPHENS; ROBERT S. STRAUSS, individually and as trustee of the ROBERT S. STRAUSS, P.C. DEFINED BENEFIT PLAN; TR 30, a New York Partnership; ULTRAMAR TRAVEL BUREAU PROFIT SHARING TRUST, UA 11-10-67 and

its TRUSTEE; UNICORP CANADA CORPORATION; UNIVERSAL LIFE CHURCH, INC. CHARTER, 30488 and BAYARD RYDER; WARM SPRINGS ASSOCIATES; WARNER W. HENRY, individually and as trustee FBO HENRY FAMILY TRUST UDT DTD 12/04/82; WARUDA HOLDINGS, LTD.; ABRAHAM WEISS; RUTH WEISS; WELLS FARGO BANK, individually and as trustee of the Extended Market Fund for EBT, 368-500069 and its Participants; WELLS FARGO BANK, individually and as trustee for WALTER LEBAND TRUST (or Francine LeBand, individually and as executor for the Estate of Walter LeBand); JEFFREY WENDEL; WERTHEIM SCHRODER & CO., INC.; WHEEL BARROW & CO.; WIFT & CO.; HARRY WILF; JOSEPH WILF; Y PARTNERSHIP; Z.H. ASSOCIATES; ESTATE OF GERALD L. CONRAD, doing business as Conrad Sales Co.; MCCOSKER PARTNERS; and THE FIRST BOSTON CORPORATION,

Defendants-Appellees,

and

SECURITIES EXCHANGE COMMISSION,

Appellee,

and

JOSEPH H. WHITNEY,

Defendant.

APPEAL FROM THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
(D.C. NOS. 89-Z-1721 AND 89-Z-1722)

John P. Frank of Lewis and Roca, Phoenix, Arizona (Marty Harper and Susan M. Freeman of Lewis and Roca, Phoenix, Arizona; G. Stephen Long and David J. Richman of Coghill & Goodspeed, Denver, Colorado, on the briefs), Attorneys for Appellants.

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Katherine Gresham of the United States Securities and Exchange Commission, Washington, D.C. (Rosalind C. Cohen and Joseph H. Harrington of the United States Securities and Exchange Commission, Washington, D.C., and Thomas D. Carter, Regional Trial Counsel, Securities and Exchange Commission, Denver, Colorado), for Securities and Exchange Commission.

Joseph Meyer, III, and Michael E. Romero of Pendleton & Sabian, P.C., Denver, Colorado; Henry L. Hobson and Lynn Bolinski of Holland & Hart, Denver, Colorado; Douglas M. Schwab and Joseph A. Gross of Heller, Ehrman, White & McAuliffe, San Francisco, California; and Jack Corinblit and Marc M. Seltzer of Corinblit & Seltzer, Los Angeles, California, Counsel for remaining defendants in consolidated cases.

Before **HOLLOWAY, ANDERSON,** and **BRORBY,** Circuit Judges.

ANDERSON, Circuit Judge.

The question presented in this appeal is whether consideration paid to shareholders for their stock in connection with a leveraged buy out is exempt from the avoiding powers of a trustee under section 546(e) of the Bankruptcy Code, as "settlement payments" made "by or to a . . . stockbroker, financial institution, or securities clearing agency." 11 U.S.C. § 546(e). In its order granting defendants' motion for summary judgment, the district court held that such payments fall within the exemption found in section 546(e). We agree and, therefore, affirm the judgment of the district court.

I. INTRODUCTION

This case involves a leveraged buy out gone bad. Making use of the modern counterpart of a centuries-old statute, Kaiser Steel Resources, Inc. ("Kaiser"), formerly known as Kaiser Steel Corporation ("Kaiser Steel"), seeks in the underlying action to retrieve amounts paid out to former Kaiser Steel shareholders in connection with a leveraged buy out of the company in 1984 (the "LBO"). Kaiser makes the relatively novel yet increasingly popular claim that these payments constitute a fraudulent conveyance. The current battle is much more narrow, however. It surrounds the construction of a Bankruptcy Code (the "Code") exemption that prohibits the trustee from avoiding "settlement payments" made by or to stockbrokers, financial institutions, and clearing agencies. See 11 U.S.C. § 546(e). Appellees, joined by

the Securities and Exchange Commission ("SEC"),[1] maintain that the section 546(e) exemption encompasses amounts paid to the shareholders in the LBO and accordingly prevents Kaiser from unwinding the transaction.

A. The Leveraged Buy Out.

In late 1983, the board of directors of Kaiser Steel agreed to the LBO. Under the plan, Kaiser Steel would merge with a new entity owned by a group of outside investors. Upon the merger, all outstanding shares of Kaiser Steel common stock would be converted into the right to receive twenty-two dollars and two shares of preferred stock (the "LBO consideration") in the surviving entity. The money, which amounted to $162 million, was to come from Kaiser Steel's cash reserves and a $100 million loan from Citibank secured by the corporation's assets.

The shareholders approved the LBO on January 18, 1984. As of the effective date of the merger, February 29, 1984, the former holders of Kaiser Steel common stock were required to tender their shares to Kaiser's disbursing agent, Bank of America, in order to receive the cash and preferred stock. The New York Stock Exchange delisted the stock the following day.

Most of the common stock was in the possession of Depository Trust Company ("DTC"), a securities clearing agency acting as depository. After the merger, DTC tendered the certificates to

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[1] The SEC filed a brief in this case and participated in oral argument. As a statutory party in corporate reorganization proceedings, the Commission acts as a special advisor to the courts. See 11 U.S.C. § 1109(a). Although precluded from initiating an appeal when appearing in this capacity, the Commission may participate in an appeal taken by others. Kaiser Steel Corp. v. Charles Schwab & Co., Inc., 913 F.2d 850 (10th Cir. 1990) (citation omitted).

Bank of America and received the payments of LBO consideration. DTC then transferred these payments to the accounts of its participants, including brokers and other financial intermediaries. These intermediaries, in turn, either disbursed the payments to their customers who were the beneficial owners of Kaiser Steel stock or retained the payments if they themselves were the beneficial owners. Some shares were exchanged through securities clearing agencies other than DTC, and since DTC stopped handling trades of Kaiser Steel shares prior to the effective date of the LBO, some financial intermediaries and beneficial owners were required to tender their shares directly to Bank of America.

B. History of the Case.

In 1987, Kaiser filed a voluntary reorganization proceeding under Chapter 11 of the Code. Kaiser then commenced this fraudulent conveyance action against a number of defendants, seeking to avoid the LBO and recover the $162 million. In what amounted to a test case, Charles Schwab & Co. ("Schwab"), a broker eventually named in the action, moved for summary judgment on the grounds that it was not liable because it was a "mere conduit" rather than a transferee, see 11 U.S.C. § 550(a). The argument was also made by intervening defendants that the LBO payments were exempt from avoidance as settlement payments, see 11 U.S.C. § 546(e). Schwab's only role in the transaction was to deliver its customers' Kaiser Steel shares for payment and transfer the payments it received back to the accounts of its customers.

On appeal, following the district court's reversal of the bankruptcy court's decision to deny Schwab's summary judgment motion, we held that the payments to Schwab were settlement payments exempt from recovery under section 546(e). Kaiser

Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990).

Because we affirmed the district court's decision on these grounds, we did not decide whether Schwab was a "mere conduit" rather than a transferee. Id. at 848.

Pending that appeal, in consolidated proceedings before the district court, other financial intermediaries moved for summary judgment on the basis of the section 546(e) settlement payment exemption. The district court granted summary judgment dismissing all claims asserted against the financial intermediaries and sua sponte dismissed the claims asserted against all other defendants, including beneficial shareholders of Kaiser Steel stock and brokers trading on their own account.[2] In light of our decision in Schwab, Kaiser has abandoned all claims against the appellees in this case insofar as they acted in conduit/financial intermediary capacities. Therefore, all appellees remaining before us are shareholders or brokers that beneficially owned the Kaiser Steel shares tendered in connection with the LBO.

II. DISCUSSION

We now must decide whether our holding in Schwab—that Code section 546(e) protected payments made to the financial intermediaries—should be extended to protect payments made to the beneficial shareholders.

Section 546(e) provides as follows:

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[2] The court did not dismiss the claims against a group known as the Jacob's Defendants.

> the trustee may not avoid a transfer that is a margin payment, as defined in section 101(34), [sic(38)] 741(5) or 761(15) of this title, or settlement payment, as defined in section 101(35) [sic(39)] or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency. . . .

11 U.S.C. § 546(e) (emphasis added).

Kaiser makes two primary arguments against applying this provision to the payments of LBO consideration. First, it maintains that these payments are not "settlement payments." Second, it insists that even if the payments are settlement payments, payments made "by or to" one of the enumerated entities are protected under section 546(e) only to the extent the recipient is a participant in the clearance and settlement system (i.e., a stockbroker, financial institution, clearing agency, or some other participant). Settlement payments received by an "equity security holder," according to Kaiser, are not protected.

A. Settlement Payments.

We cannot accept Kaiser's argument that the payments of LBO consideration to the beneficial shareholders are not settlement payments within the meaning of the statute. Our interpretation, as always, begins with the language of the statute itself. Section 546(e) refers to section 741(8) for the definition of "settlement payment."[3] Section 741(8), in turn, defines "settlement payment" as a "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement pay-

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[3] The definition of "settlement payment" found in section 101(39), also referred to in section 546(e), applies only to forward contracts.

ment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8) (emphasis added).

As a natural reading suggests, and as we and others have noted, this definition is "extremely broad." Schwab, 913 F.2d at 848 (quoting Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Sav. & Loan Ass'n, 878 F.2d 742, 751 (3d Cir. 1989)). See also In re Comark, 124 B.R. 806, 816 (Bankr. S.D. Cal. 1991); Blanton v. Prudential-Bache Sec., Inc., 105 B.R. 321, 347 (Bankr. E.D. Va. 1989). The clear aim of the definition is to encompass all "settlement payments" commonly used in the securities trade. Schwab, 913 F.2d at 848. See Bankruptcy of Commodity and Sec. Brokers: Hearings before the Subcomm. on Monopolies and Commercial Law of the Comm. on the Judiciary of the House of Representatives, 97th Cong., 1st Sess. 372 (1981) (1981 Hearings) (the commodities and securities industry representatives that drafted and proposed the definition explain that: "This new section is added to provide a definition for the term 'settlement payment' to include the several types of settlement payments commonly used in the securities industry.").

In applying this provision, our task is to apply the term "settlement payment" according to its plain meaning. See, e.g., Resolution Trust Corp. v. Westgate Partners, Ltd., 937 F.2d 526, 529 (10th Cir. 1991) ("The exceptions to our obligation to interpret a statute according to its plain language are few and far between." (Citing United States v. Ron Pair Enterprises, 489 U.S. 235, 242 (1989) (plain language conclusive unless it produces a result "demonstrably at odds with the intention of its drafters")). However, since even the plain meaning of a term may depend on the context within which it is given, we must interpret the term "settlement payment" as it is plainly understood within the securities

industry. See Shell Oil Co. v. Iowa Dep't of Revenue, 488 U.S. 19, 25 (1988) (A court need not look beyond the plain meaning of a statute. "But the meaning of words depends on their context."); McCarthy v. Bronson, 111 S. Ct. 1737, 1740 (1991) ("However, statutory language must always be read in its proper context.").

With respect to the routine purchase and sale of a security, there are at least two opportunities for "settlement."[4] The first ("street-side settlement") takes place between the brokers and the clearing agency during the process of clearance and settlement. The brokers submit their transactions which are matched and compared. Confirmed contracts are submitted to the clearing agency's accounting functions, and the obligations created under the separate trades are netted to arrive at each clearing member's "settlement obligations." On the "settlement date" (normally five days after the trade date) the brokers and the clearing agency, which has interposed itself between the selling broker and the buying broker, will deliver securities and receive payment. "Settlement payments" are those payments made in discharge of a party's settlement obligations. See Division of Market Regulation, Securities and Exchange Commission, The October 1987

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[4] Under this system there are also at least two corresponding sets of guarantees. The brokers guarantee that they will perform even if their customers fail to perform, and the clearing agency guarantees to perform, even if individual clearing members fail to perform. Prior to settlement, these guarantees subject the brokers and the clearing agency to a potential risk of loss, should a selling party be forced to cover the obligations of a defaulting customer or clearing member in a rising market (i.e., buy securities that cost more than the party will receive), or should a buying party be forced to buy securities in a falling market (i.e., pay more for securities than their present market value). To reduce this risk, in a fluctuating market, the clearing agency may demand certain types of "margin payments" from its clearing members, and a broker may be required to demand similar types of payments from its customers. These payments, like settlement payments, are protected under § 546(e).

Market Break at 10-5 (1988) (SEC Report); Dale A. Oesterle, Comment on the Harris Paper, 74 Cornell L. Rev. 943, 944 (1989) ("Settlement payments refer to the final payment of funds between clearing house [members] for trade[s] registered up to a specific point in time.").[5]

In addition, a "customer-side settlement" also occurs between the broker and its customer. See SEC Report at 10-2, 10-10 to 10-11; New York Stock Exchange, Language of Investing Glossary 30 (1981) (defining settlement as "[c]onclusion of a securities transaction when a customer pays a broker/dealer for securities purchased or delivers securities sold and receives from the broker

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[5] That this is a proper use in the industry of the term "settlement payment" may also be verified by several references in SEC literature. See, e.g., Exchange Act Release No. 27,505 (Dec. 5, 1989) ("Funds-only settlement payments are made to and from GSCC clearing banks by members over the cash Fed-wire."); Exchange Act Release No. 23,488 (July 31, 1986); Exchange Act Release No. 22,778 (Jan. 8, 1986) (discussion of clearance and settlement system in which clearing agency generates settlement figures, but instead of guaranteeing settlement payment, participants are required to make the payments between themselves); Exchange Act Release No. 22, 599 (Nov. 6, 1985). Cf. 11 U.S.C. § 741(7) (the definition of "securities contract" includes "the guarantee of any settlement of cash or securities by or to a securities clearing agency"); 11 U.S.C. § 362(b)(6) (refers to cash, securities, or other property held by or due from a stockbroker, financial institution, or securities clearing agency to "settle" securities contracts).

Apart from protecting margin payments to brokers, the original Code provision as well protected only settlement payments by or to the clearing agency. Actually, on its face the 1978 predecessor of 546(e) prevented the trustee from avoiding "settlement payment[s] made by a clearing organization." 11 U.S.C. § 764(c) (1978). Apparently through "inadvertence," the provision failed to note that settlement payments to a clearing agency were also protected, so a colloquy was entered into the legislative history to clarify this. See 124 Cong. Rec. 17,433 (Oct. 6, 1978). In fact, the "by or to" language in the present Code provision was designed in part to officially implement this clarification. 1981 Hearings at 205, 232.

the proceeds of a sale"); J. Low, The Investor's Dictionary, 169 (1964) ("Settlement day is the day by which a buyer of securities must pay his broker for his purchases and a seller must deliver to his broker negotiable certificates for any securities he has sold."). Logically, the term "settlement payment" may also be used to describe payments made to settle a customer's account with its broker. Cf. 1981 Hearings at 294 (Statement by Jack Nelson, President, National Securities Clearing Corporation) ("Prior to the Code, the securities industry knew for certain that margin, mark-to-market, deposit and settlement payments made by a securities customer or broker to a clearing broker or a clearing agency . . . could not be voided"); id. at 492 (Statement by the Securities Industry Association) (referring to the "traditional right of brokers and their clearing agencies to close out the accounts of insolvent brokers and customers to retain margin, mark-to-market and settlement payments").

No party before us, including Kaiser, argues that a shareholder cannot make or receive a settlement payment, as that term is defined in section 741(8), with respect to a "routine" purchase of securities. See Appellant's Opening Brief at 14 (referring to "obligations of an insolvent customer or broker to make settlement payments"); id. at 16 (citing reference in legislative history to "settlement payment owed to a customer").[6] Instead, Kaiser argues that the term "settlement payment" when applied to shareholders only applies to such routine securities transactions, not an extraordinary securities transaction like the leveraged buy out. For example, it notes that definitions used in Schwab to sup-

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[6] While Kaiser does not argue in the abstract that "settlement payments" may not be made to a customer, it does argue that section 546(e) does not protect settlement payments to customers.

port the broad notion that "settlement" is "the completion of a securities transaction," 913 F.2d at 849, in fact refer to securities trades.[7] Similarly, Kaiser asserts that the scope of section 546(e) does not extend beyond the "securities contract." 11 U.S.C. § 741(7).

In Schwab, we recognized that "Kaiser's position that section 546(e) was only intended to insulate from avoidance routine securities transactions is not without merit." 913 F.2d at 850. However, we continue to note that while Congress might have chosen otherwise, neither § 546(e) or § 741(8) is on its face limited to "securities contracts," as defined by the Code, or to "trades," as defined by Kaiser. Compare 11 U.S.C. § 546(e) with 11 U.S.C. § 362(b)(6) (a companion provision to § 546(e) that names the same entities and explicitly refers to margin and settlement payments "arising out of commodity contracts, forward contracts, or securities contracts" (emphasis added)). Cf. Gozlon-Peretz v. United States, 111 S. Ct. 840, 846-47 (1991) ("where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate in-

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[7] See Appellant's Opening Brief at 8-9. For example, it notes that A. Pessin & J. Ross, Words of Wall Street: 2000 Investment Terms Defined, cited restrictively to define settlement as "the completion of a securities transaction," more fully defines the term as an "Industry term for the completion of a securities transaction (i.e., a buyer pays for and a seller delivers the security purchased to the buyer.)" "Transaction" is defined in that source as follows: "Used synonymously for a trade (i.e., a completed agreement between a buyer and a seller)." Id. at 271.

clusion or exclusion" (quoting Russello v. United States, 464 U.S. 16, 23 (1983))).[8]

Given the wide scope and variety of securities transactions, we will not interpret the term "settlement payment" so narrowly as to exclude the exchange of stock for consideration in an LBO. As the appellees and the SEC have urged, there is no reason to narrow the plain concept of "settlement" to a single type of securities transaction. The Code has been expanded to explicitly cover five different types of financial transactions, all of which, with the exception of swap agreements, involve "settlement payments" of one form or another.[9] In fact, the definition of "settlement payment" found in § 741(8) also applies to payments made in connection with a repurchase agreement, which is not a "trade" entered into on an exchange, and which involves a completely different

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[8] Congress has also shown itself capable of restricting the counterparts of § 546(e) to a particular type of transaction. See 11 U.S.C. § 546(f) (refers to settlement payments made by or to a repo participant, "in connection with a repurchase agreement") (emphasis added) and 11 U.S.C. § 546(g) (refers to transfers made by or to a swap participant, "in connection with a swap agreement") (emphasis added).

[9] These transactions are the "securities contract," see 11 U.S.C. § 741(7), the "repurchase agreement," see 11 U.S.C. § 101(47), the "commodity contract," see 11 U.S.C. § 761(4), the "forward contract," see 11 U.S.C. § 101(25), and the "swap agreement," see 11 U.S.C. § 101(55). With regard to the securities contract and the repurchase agreement, the definition of "settlement payment" is found in section 741(8), which refers to types of settlement payments commonly used in the "securities trade." See 11 U.S.C. § 741(8). For the forward contract, the definition of "settlement payment" is found in section 101(39), which refers to types of settlement payments commonly used in the "forward contract trade." See 11 U.S.C. § 101(39). For commodity contracts, various types of settlement payments are included within the definition of "margin payment" found in section 761(15), including "daily settlement payments" and "final settlement payments made as adjustments to settlement prices." See 11 U.S.C. § 761(15).

settlement process. See Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Sav. & Loan Ass'n, 878 F.2d 742, 752 (3d Cir. 1989).

While the leveraged buy out may not be a "routine" securities trade, at least as viewed by Kaiser, we cannot deny what in substance took place here. The LBO was a securities transaction, varying only in form from the various other ways in which a shareholder's equity interest can be sold. The former Kaiser Steel shareholders effectively sold their equity interests to the new investors in exchange for money and a continuing stake in the new entity as preferred shareholders. In settlement of that transaction, the Kaiser Steel shareholders tendered their shares and received payment. These payments were "settlement payments." Schwab, 913 F.2d at 850.

Consequently, those shareholders who tendered their shares one day after the LBO and received the LBO consideration are treated just the same under the Code as shareholders who sold their shares in the market one day prior to the LBO and received a settlement payment reflecting the market value of the LBO consideration. Neither type of investor will be forced to disgorge the payments several years later.[10]

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[10] For the public customer, this symmetry of treatment is justified not only by application of the plain notion of "settlement." As well, it is justified by Congress' policy interests in promoting finality and "in promoting speed and certainty in resolving complex financial transactions." H. Rep. No. 484, 101st Cong., 2d Sess. 2 (1990), reprinted in 1990 U.S.C.C.A.N. 224. See also Schwab, 913 F.2d at 848 ("Such an interpretation 'is consistent with the legislative intent behind § 546 to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions.'" (citation omitted)).

(continued)

B. "By or To."

Finally, Kaiser argues that even if the payments were settlement payments, § 546(e) does not protect a settlement payment "by" a stockbroker, financial institution, or clearing agency, unless that payment is to another participant in the clearance and settlement system and not to an equity security holder. We disagree.

On its face the statute is clear. The statute exempts payments made "by or to" a stockbroker, financial institution, or clearing agency. Again, unless there is some reason to believe the clear application is absurd or otherwise unreasonable, we can leave our inquiry at that.

Kaiser apparently does not deny that these transfers were in fact made to each beneficial shareholder, either by the shareholder's stockbroker, a clearing agency, or a financial in-

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[10] *(...continued)*

For the broker trading on its own account, our holding is consistent with even the strictest notion of "settlement payment" (i.e., a notion tied to the clearance and settlement system). This is true particularly to the extent a broker's settlement obligations to a clearing agency or participant were calculated with regard to the payments of LBO consideration. Cf. Brief of Appellee at 12, Kaiser Steel Resources, Inc. v. Charles Schwab & Co., Inc. (referring to parties' stipulation that Schwab's settlement obligations to clearing agency (NSCC) were calculated by reference to "daily cash settlement" figures generated by DTC). Further, as the SEC has emphasized, this holding is supported by Congress' policy of promoting the health of the clearance and settlement system, which by all accounts is one of the fundamental aims of the 546(e) exemption. See Schwab, 913 F.2d at 848-49.

For a contrary view, see Weibolt Stores, Inc. v. Schottenstein, No. 87 C 8111, slip op. at 14-19 (N.D. Ill. Sept. 16, 1991); Neil M. Garfinkel, Note, No Way Out: Section 546(e) Is No Escape for the Public Shareholder of a Failed LBO, 1991 Colum. Bus. L. Rev. 51 (1991).

stitution. Instead, relying on the legislative history and the exclusion of the word "equity security holder" among the parties listed in section 546(e), it urges that we must interpret the "by or to" language in a way that only protects payments received by brokers (except those trading on their own account), financial institutions and clearing agencies, or other participants in the clearance and settlement process. Whether or not this formulation accurately reflects Congress' "intent", and there is good reason to believe that it does not,[11] Kaiser has given us no reason to replace the unambiguous language of the provision with clues garnered from the legislative history. See Miller v. Commissioner, 836 F.2d 1274, 1283 (10th Cir. 1988) ("When there is a conflict between portions of legislative history and the words of a statute, the words of the statute represent the constitutionally approved method of communication, and it would require 'unequivocal

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[11] It is difficult to imagine, for instance, how Congress could recognize that a settlement payment may be made by a stockbroker to its customer (whether that customer is bankrupt or not), see Appellant's Opening Brief at 16 (citing reference in legislative history to "settlement payment owed to a customer"), and not realize that section 546(e), which on its face protects settlement payments by a stockbroker, is likely to be read by a court to protect settlement payments by a stockbroker to its customer.

Further, Kaiser's claim that § 546(e) does not protect brokers trading on their own account is clearly wrong. Kaiser argues that such brokers are "equity security holders" and not "stockbrokers." It notes as well that "stockbrokers" must have "customers." 11 U.S.C. § 101(54)(A). However, the definition of "stockbroker" was intentionally fashioned to include dealers who "effect[] transactions in securities . . . with members of the general public, from or for such person's own account." 11 U.S.C. § 101(54)(B) (emphasis added), and "customer," as used in the Code is a term of art, broadly defined in § 741(2) to "include anybody that interacts with the [broker] in a capacity that concerns securities transactions." S. Rep. No. 989, 95th Cong., 2d Sess. 100 (1978), reprinted in 1978 U.S.C.C.A.N. 5886. The customer requirement was apparently designed only to prevent employees of brokers from claiming the benefits of certain Code provisions. See S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978), reprinted in 1978 U.S.C.C.A.N. 5813.

evidence' of legislative purpose as reflected in the legislative history to override the ordinary meaning of the statute."). Certainly, we cannot say that the clear application is absurd, given the fact that disruption in the securities industry—an inevitable result if leveraged buy outs can freely be unwound years after they occurred—is also a harm the statute was designed to avoid. See Schwab, 913 F.2d at 848-49. Accordingly, we must reject Kaiser's argument.

While we acknowledge that our holding in this case is broad in its application, we are not convinced it leaves the trustee remediless by way of a suit for damages, or some similar device, against specific individuals or institutions for unlawful acts.

Accordingly, for the reasons given above, the judgment of the district court is AFFIRMED.

[Filed December 30, 1991.]

APPENDIX B

APPENDIX B

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO

In re:	)	
	)	
KAISER STEEL CORPORATION,	)	Bankruptcy No. 87 B 1552 E
	)	(Jointly Administered)
Debtor(s).	)	
	)	
KAISER STEEL CORPORATION,	)	
	)	
Plaintiff,	)	Adversary No. 87 E 137
	)	
vs.	)	
	)	
IRWIN L. JACOBS, et al.,	)	
	)	
Defendants.	)	

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ORDER ON MOTION FOR SUMMARY JUDGMENT

This matter comes before the Court on the Motion for Summary Judgment and supporting brief ("Motion") filed by Charles Schwab & Co., Inc. ("Schwab") and responses thereto filed by Kaiser Steel Corporation ("Kaiser"). A number of other Defendants have filed simple pleadings merely stating their joinder in the substance of Schwab's Motion and Reply. Others, however, have filed briefs joining in the substance of Schwab's Motion and supplementing it with additional legal argument.

I. BACKGROUND AND PROCEDURE

On February 27, 1987, Kaiser commenced this litigation seeking to recover from certain defendants funds transferred in early 1984 and thereafter as part of the leveraged buyout ("LBO") of Kaiser which occurred in 1984.[1] In September, 1987 Kaiser amended its complaint to add as defendants over 150 brokerage houses. The Amended Complaint is brought pursuant to 11 U.S.C. § 541, 544, 548 and 550; Cal. Civil Code § 3439.01 et seq. (1985); and common law. The defendants include: (1) several who attempted a hostile takeover of Kaiser in advance of the LBO; (2) nominees of clearing houses and clearing houses; (3) discount brokers; and (4) full-service brokerage houses. Schwab is and was a discount securities broker at all times relevant to this matter.

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[1] On February 29, 1984, all stockholders of Kaiser were required to tender their shares to Kaiser in exchange for the right receive $22.00 in cash plus one share of Series A preferred stock and one share of Series B preferred stock in the surviving entity.

A. Arguments of the Parties.

Schwab, in its Motion, asserts that because it is a discount securities broker and does not generally buy and sell securities for its own account nor act as a market-maker in any security, it should be found to be a "mere conduit" and not subject to liability as an initial transferee within the context of 11 U.S.C. § 550. Schwab also asserts that while it held securities in "street name"[2] it did so solely as a nominee for the beneficial owners of the securities, its customers. Schwab argues alternatively that if the Court construes the language of 11 U.S.C. § 550 strictly and finds that Schwab is a transferee, the Court should exercise its equitable powers granted under 11 U.S.C. § 105 to prevent recovery from Schwab, an innocent party who derived nothing from the LBO.

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[2] The term refers to the practice of registering securities in other than the name of the beneficial owner, a device used most frequently by banks or brokerage firms as owners of record on behalf of the individual or institutional investors. *In re Franklin National Bank Securities Litigation*, 574 F.2d 662, 664 n.2, *citing Security and Exchange Commission*, Final Report to Congress on The Practice of Recording the Ownership of Securities and the Records of the Issuer in Other Than the Name of the Beneficial Owner of Such Security [Street Name Study; Final Report] (December 3, 1976), Fed. Sec. L. Rep. (CCH) No. 672 (1976), at pg. 1; and *Securities and Exchange Commission*, Preliminary Report of December 4, 1975, on The Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities [Street Name Study; Preliminary Report] (December 4, 1975), Fed. Sec. L. Rep. (CCH) No. 619 (1975), at pgs. 1-2. A principal purpose of such registration is to facilitate transfer the securities. An additional purpose is confidentiality on the part of the beneficial owner, but also on the part of his broker who seeks to conceal his customer's identity from other brokers who will learn it in the settlement of trades. *Blanc and Quinn*, The Right of Access to Record Holder and Other Shareholder Listings, Practicing Law Institute (1987), PLI Order No. 84-6810; *accord Fradkin v. Ernst*, 571 F. Supp. 829, 839, n.16 (N.D. Ohio, E. Div. 1983).

Bear Stearns & Co., Inc., Cowen & Co., Inc., Doft & Co., Inc., L.F. Rothschild & Co., Inc., Unterberg, Towbin, Shearson Lehman Brothers/American Express, Inc. and Smith, Barney, Harris, Upham & Co., Inc. ("Bear Defendants") have filed a separate brief joining in Schwab's Motion ("Bear Joinder"). The majority of joining pleadings filed by other defendants have echoed the arguments presented by Schwab. The Bear Defendants, however, have raised a novel argument. They argue the applicability of 11 U.S.C. § 546(e) which limits the trustee's ability to recover either a margin or settlement payment from a broker.

Kaiser, in response, argues that Schwab is a "transferee" within the meaning of § 550 as follows: (1) Schwab had sufficient dominion and control over the LBO funds, not only because Schwab held the shares in "street name," but also because Schwab and its beneficial owners had agreements whereby the beneficial owners granted Schwab a lien against the LBO funds it received from one of the clearing houses and the disbursing agent; (2) the Court should construe literally the language of section 550 and refrain from "equitable redrafting;" and (3) Schwab cannot rely on its agency relationship as a defense to its liability when its principals were undisclosed at the time of the transfer and when Kaiser dealt with Schwab directly.

In their Reply to the Bear Joinder, Kaiser contends that section 546(e) is inapplicable because section 546(e) does not apply unless the debtor is a stock or commodities broker. If it does apply, the LBO Consideration is not a settlement payment, but payment for a mandatory redemption of stock. Kaiser also urges that the application of section 546(e), in this instance, would lead to the absurd result of precluding the avoidance of any transfers made in the course of a leveraged buyout that passes through securities' brokers or clearing houses.

II. UNDISPUTED FACTS

The parties have filed a Joint Statement of Facts concerning Schwab's Motion ("Joint Statement of Facts"). The following relevant and uncontested facts are taken from the Joint Statement of Facts and briefs of the parties. They are as follows:

A. Schwab.

1. Schwab is and was a discount securities broker which executes securities' transactions on an agency basis for its customers.

2. Schwab has a corporate policy against recommending specific securities and offering investment and voting advice to its customers.

3. Schwab has represented that during the period of time in question (i.e., prior to March 1986), it was using account agreements with its customers in one or more of the forms attached as Exhibits 1-16 to the Joint Statement of Facts.

4. All of the customer agreements provide that Schwab does not act as an investment counselor or advisor.

5. All of the customer agreements used by Schwab provide that all securities and money held in Schwab accounts are subject to a lien for the discharge of all customer indebtedness to Schwab.

6. Each Schwab margin and short account agreement authorizes Schwab to pledge and repledge all securities in Schwab's possession held for the account of a customer for the amount due Schwab from the customer or for a greater sum.[3]

7. Schwab executes trades on a principal basis in certain limited circumstances.[4] It does not, however, generally buy and sell securities for its own account and does not act as a market-maker in any security.

8. Schwab owns securities as a nominee for its customers, the beneficial owners of the securities.

B. 1984 KAISER LBO.

9. Kaiser prepared and issued a proxy statement and prospectus to its shareholders on December 9, 1983, advising them of the annual shareholders' meeting to be held on January 18, 1984, and the proposed LBO transaction.

10. At the shareholders' meeting on January 18, 1984, the majority of shareholders of Kaiser common stock approved the proposed LBO. As a result, on February 29, 1984, all shareholders, including Schwab's customers, were required to

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[3] *See infra* note 6.

[4] In an "agency" trade, the broker purchases a security at its customer's order and charges the customer a commission for executing the trade. The broker acts as a principal when it sells the customer a security owned by the broker. In a "principal" trade the broker does not charge a commission but receives its compensation (if any) by selling the stock at a price in excess of the price paid by the broker when it acquired the stock (referred to in the industry as the "mark up.")

tender all of their shares to Kaiser in exchange for the right to receive for each share $22.00 in cash plus one share of Series A preferred stock and one share Series B preferred stock in the surviving entity. ("LBO Consideration").

11. Bank of America agreed to be the Kaiser "disbursing" agent for the 1984 LBO transaction. Bank of America was authorized to obtain the return of Kaiser common stock and to distribute the LBO Consideration. Bank of America was also to act as registrar for the new preferred stock.

C. DIVIDENDS.

12. Schwab's records reflect that on the date indicated it credited the following amounts as dividends on the Series A and Series B stock to its customers:

DATE	AMOUNT
May 15, 1984	$ 7,828.75
August 15, 1984	20,809.11
November 15, 1984	30,791.06
February 15, 1985	30,002.03
May 15, 1985	33,020.62
August 15, 1985	31,062.43
November 15, 1985	33,249.54
February 15, 1986	25,864.74

III. ISSUE

The issue presented by these facts is whether Schwab, and other discount brokers who held stock of Kaiser in "street name", can be held liable as an initial transferee of the LBO Considera-

tion within the meaning of section 550 when it is known in the industry that such brokers generally do not trade on their own account.

IV. ANALYSIS AND CONCLUSIONS OF LAW

In order to prevail, Kaiser must ultimately prove the elements of sections 544 and 548 and the California fraudulent conveyance statutes. The question which then arises is, from whom can Kaiser recover under section 550? 11 U.S.C. § 550(a) states in pertinent part:

> Except as otherwise provided in this section, . . . the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee. (Emphasis added).

The Bankruptcy Code does not define "transferee." Thus, courts have grappled with this concept particularly where the defendant is an "innocent" link in the commercial chain. *In re Cash Currency Exchange, Inc.*, 1987 WL 46369 (Bankr. N.D. Ill. Sept. 25, 1987) (No. 85A145, 85A146). As a result, courts have devised the "mere" or "commercial conduit" theory to determine whether an entity which receives a transfer is a "transferee". The phrase "mere conduit", or some variation thereof, has been coined by various courts to characterize those "innocent" entities which are only agents or passthroughs of the transferee. Before

delving into a critique of this theory, a review of the significant cases which have invoked the "mere conduit" theory is instructive, not only to discern whether any definition of "transferee" can be gleaned, but also to gain an understanding of this theory.

The seminal case is *In re Fabric Buys of Jericho, Inc.*[,] 33 B.R. 334 (Bankr. S.D.N.Y. 1983). It is also one of the first cases in which the court utilized the phrase "mere conduit."[5] In that case the Court found that a law firm was not liable as an initial transferee for the funds which it received from the opposing party to settle a dispute with one of the law firm's clients. The language from the *Fabric Buys* case which is particularly enlightening is as follows:

> The Hopgood firm acted as a mere conduit of funds from Fabric Buys to Unitrac (its client). As one commentator states, an initial transferee is one who deals directly with the debtor. 4 *Collier on Bankruptcy* ¶ 550.01, at 550-3 (15th ed. 1983). Here Unitrac had the direct business dealings with Fabric Buys that gave rise to the debt, subsequent suit, and the allegedly preferential payment. That such amount was funneled through the escrow account does not make Unitrac's lawyer an initial transferee. *Id.* at 337.

The *Fabric Buys* court also intimated that the court could exercise equitable powers to achieve a different result:

> Even if the Hopgood firm were deemed an initial transferee, the circumstances of this case, as stated above, would permit

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[5] *See infra* note 6.

this Court to exercise its equitable discretion and prevent the Trustee from recovering a preference from the Hopgood firm. As one commentator has stated:

> In some circumstances, a literal application of section 550(a) would permit the Trustee to recover from a party who is innocent of wrong-doing and deserves protection. In such circumstances the bankruptcy court should exercise its discretion to use its equitable powers under section 105(a) and 28 U.S.C. § 1481 to prevent an inequitable result . . . *Ibid, citing 4 Collier on Bankruptcy* ¶ 550.02, at 550-7 (15th ed. 1983).

Id. at 337.

Although the court did not invoke its equitable powers, it remarked: "Hopgood acted as the agent of Unitrac, a mere conduit of funds from Fabric Buys to Unitrac, such funds passing through an escrow account maintained by the Hopgood firm for client monies alone." *Id.*

The next in this line of cases is *In re Black & Geddes, Inc.*, 59 B.R. 873 (Bankr. S.D.N.Y. 1986). In *In re Black & Geddes* the Chapter 7 trustee of a freight forwarder brought an action against a steamship agency acting on behalf of a common carrier to collect payment for the freight due on the carrier's bill of lading. The trustee sought to recover the payment made to the agency as a preference. It was undisputed that the bill of lading for the shipment in question was issued by the common carrier. The steamship asserted as a defense that it was only an agent for a disclosed principal, the common carrier.

The court found first that the trustee could not recover a preference from the steamship agency because there was no antecedent debt existent between the debtor and the agency. Next, the court disagreed with the trustee that, regardless of that fact, section 550 permitted recovery from the agency as an initial transferee. The court relied on the holding of *In re Fabric Buys of Jericho, Inc.* that "an entity that acts as a mere conduit of funds is not an initial transferee within the ambit of section 550 and no recovery may be had from the entity." *Id.* at 875, *citing accord, 4 Collier on Bankruptcy* (15th ed. 1985) ¶ 550.02 at 550-7 to 550-8.[6]

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[6] Despite its holding the court noted in a footnote that:

> In an appropriate case, there may be the possibility of a recovery from an entity as an initial transferee under Code § 550 even though that entity did not receive a preference under Code § 547. That situation would arise, for example, in this case if Nedlloyd [the steamship agency] had not yet made payment over to Hoegh [the common carrier] at the time the case was commenced and arguably could exist relative to the amount retained as a commission. Nedlloyd would then have been holding funds which could be recovered by the estate if it could be shown that payment to Hoegh would be a preferential transfer. Thus, this court finds continued vitality in Judge Cardozo's discussion in *Carson v. Federal Reserve Bank*, 254 N.Y. 218, 235-36, 172 N.E. 475 (1930) ("The person to be charged with liability, if he has parted before the bankruptcy with title and possession, must have been more than a mere custodian, an intermediary or conduit between the bankrupt and the creditor. Directly or indirectly he must have had a beneficial interest in the preference to be avoided, the thing to be reclaimed"). *Id.* at 875 n.4.

The first district court to visit this issue was the District Court for the Southern District of Florida.[7] In *In re Colombian Coffee Co., Inc.*, 75 B.R. 177 (S.D.Fla. 1987), the trustee of the debtor corporation sought to recover funds, allegedly constituting a fraudulent transfer, from a bank where a second corporation maintained its account and into which the funds were deposited via a wire transfer.

The district court was persuaded by the reasoning in *In re Fabric Buys* and *In re Black & Geddes* and the application of the "commercial conduit" theory under these circumstances. *Id.* at 178. This court, like the *Black & Geddes* court, cited Judge Cardozo's discussion of the conduit theory in its entirety.[8] It then found that "[i]t is undisputed that the Bank acquired no beneficial interest from the wire transfers and exhibited no bad faith. In addition, the Bank possessed no discretion with respect to the disposition of the funds—it was constrained to follow the debtor's instructions." *In re Colombian Coffee Co., Inc., supra* at 179, *citing In re Colombian Coffee,* 59 B.R. 643, 644 (Bankr. S.D.Fla. 1986). The trustee, to no avail, had urged the judge to read the statutory language of

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[7] The District Court for the District of Columbia tacitly recognized the innocent transferee concept only a couple of months before this. *In re Auto-Pak, Inc.*, 73 B.R. 52 (D.D.C. 1987). In that case the court, however, rested its decision on 11 U.S.C. § 550(b):

> The crux of this case concerns whether the IRS should be held liable under § 550 (a)(1) or protected under § 550(b) . . . It would defy logic to hold an innocent and mediate party such as the IRS a party to this alleged fraudulent conveyance; in fact the IRS satisfies all of the necessary prerequisites for protection under Section 550(b). . . . *Id.* at 54.

The court found that the company's president, not a defendant, was the initial transferee by his conduct in taking control of the funds to pay another company's debt, thereby insulating the IRS from the fraudulent conveyance. *Id.*

[8] *See supra*, note 6.

section 550 literally and hold this defendant to be an initial transferee. The court refused to literally apply section 550 to the facts before it and hold the bank liable merely because it received the wire transfer for its customer's account.

In January 1988, the Seventh Circuit, the first circuit court to confront this emerging theory, augmented the "mere conduit" concept. It introduced the "dominion and control test" to determine transferee status. *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890 (7th Cir. 1988).[9] In *Bonded* an individual, Michael Ryan, who had borrowed money from the defendant bank, was the officer of a number of currency exchanges in Illinois. One of the currency exchanges, Bonded Financial Services, issued $200,000.00 to Ryan by sending a check to the defendant bank payable to the bank's order with a note directing the bank to deposit the check into Ryan's account. After so doing, Ryan instructed the bank to debit the account and pay the balance of the loan of another one of his businesses. *Id.* at 891.

The *Bonded* court also concluded that the bank was not liable as a transferee. It remarked:

> We think the minimum requirement of status as a "transferee" is dominion over the money or other asset, the right to put the money to one's own purposes. When A gives a check to B as agent for C, then C is the "initial transferee"; the agent may be disregarded. This perspective had impressive support under the 1898 Code, *e.g., Mayo v. Pioneer Bank*

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[9] One court has identified another test—whether the transfer was "solely for the purpose of benefiting the eventual transferee." *In re Mill Street, Inc.*, 96 B.R. 268, (9th Cir. BAP 1989), *citing In re Dietz*, 94 B.R. 637, 643 (9th Cir. BAP 1988).

> *& Trust Co.*, 270 F.2d 823, 830 (5th Cir. 1959) (disregarding corporate forms in order to identify the entity with control over the assets), and has been employed under the 1978 Code as well, *e.g.*, *In re Colombian Coffee Co.*, 75 B.R 177, 178-79 (S.D.Fla. 1987), *affirming* 64 B.R. 585 (Bankr. S.D. Fla. 1986). *See also In re Auto-Pak, Inc.*, 73 B.R. 52 (D.D.C. 1987). *Id.* at 893.

The court opined that "[i]f the note accompanying Bonded's check had said: 'use this check to reduce Ryan's loan' instead of 'deposit this check into Ryan's account' section 550(a)(1) would provide a ready answer. The bank would be the 'initial transferee' and Ryan would be the entity for whose benefit [the] transfer was made.'" *Id.* at 892.[10]

The *Bonded* court also addressed the ancillary issue of whether the bankruptcy court should use its equitable powers to excuse certain types of transferees, specifically agents, from repaying the preference or fraudulent transfer. The Seventh Circuit noted:

> We are aware that some courts say that an agent (or a bank in a case like ours) is an "initial transferee" but that courts may excuse the transferee from repaying using equitable powers. *See, e.g., Colombian Coffee Co.*, 75 B.R. at 179-80 (alternative holding); *In re C-L Cartage Co.*, 70 B.R. 928 (Bankr. E.D.Tenn. 1987). This is misleading. "Transferee" is

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[10] On this point this Court's analysis would diverge from that of the *Bonded* court. In this scenario, the bank does not have unrestricted use of the funds. It must apply them as *Bonded* has directed, and therefore still acts as an agent. Ryan remains the transferee and the bank benefits by having the loan to Ryan paid down. Certainly, the bank would not escape liability. Rather it would be liable as the entity for whose benefit the transfer is made. 11 U.S.C. § 550(a)(1).

not a self-defining term; it must mean something different from "possessor" or "holder" or "agent". *Id.* at 894.

The Seventh Circuit in fact expressed its concerns about this mechanism:

> We have serious doubts about the amount of equity in (the transferee's) position. . .and about the propriety of judges' declining to enforce statutes that produce inequitable results. Bankruptcy statutes are not special cases. *See Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562, 566 (7th Cir. 1986[]); *In re Chicago Milwaukee, St. Paul & Pacific R.R.*, 791 F.2d 524, 528 (7th Cir. 1986). *See also, e.g., Official Committee v. Mabey,* 832 F.2d 299, 302 (4th Cir. 1987); *Guerin v. Weil, Gotshal & Manges,* 205 F.2d 302, 304 (2d Cir. 1953) (A. Hand, J.). We mention the problem not to resolve it (for it is not before us) but to show that this appeal to "equity"—to deny recovery against an "initial transferee" within the statute—is different in source and scope from the way in which we have employed considerations of policy to define "transferee" under § 550(a)(1). Doubts about this use of equity do not imply that courts should take "transferee" for all it could be worth rather than for what a sensible policy implies it is worth. *Id.* at 894-895.

Finally, and more recently, in *In re Chase & Sanborn Corp.*, 848 F.2d 1196 (11th Cir. 1988) the Eleventh Circuit also analyzed this issue of "conduit liability." It followed *Bonded's* lead and applied the "dominion and control" test. The Chapter 11 trustee sought to avoid a fraudulent transfer from a bank where the debtor maintained a checking account. In the normal course of business the defendant bank's clearing house bank would pay a check drawn on defendant bank. "If there [were] insufficient funds to cover the

check drawn on the account, the payment of the check [would] automatically create an overdraft on paper." *Id.* at 1197. The defendant bank, however, would not take action on the check until noon of the following business day allowing time to inform the clearing house whether it would honor or return the check. Defendant bank would first contact the debtor to be sure that there were funds to cover the check and then contact the bank to approve the payment. *Id.* at 1198. In this particular instance, a lapse in time, approximately 24 hours, occurred between when the overdraft was created and when the transfer of funds to the account actually occurred. It was this amount which the trustee sought to recover. The Eleventh Circuit held that the defendant bank was not a "transferee". It invoked the "control test" and, viewing the transaction as a whole, found that the checks paid on the overdraft did not establish a "debtor-creditor relationship" between the debtor and the defendant bank. The control test, the court explained, "requires courts to step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable." *Id.* at 1199.

> We are not creating new law, or even expanding on the existing doctrine. Bankruptcy courts considering the question of whether a defendant is an initial transferee have traditionally evaluated that defendant's status in light of the entire transaction. And, in the past, courts have refused to allow trustees to recover property from defendants who simply held the property as agents or conduits for one of the real parties to the transaction. *Id.* at 1199-1200.

Thus the theory of "conduit liability" has emerged from courts' efforts to define the term "transferee."[11] What this Court divines from this line of cases is that these courts have employed, in essence, the basic principles of agency theory regardless of the precise terms used. Moreover, there is a common thread. In no instance where a court finds a defendant to be a "mere conduit" is there a direct creditor/debtor relationship or any other direct contractual relationship specifically related to the funds transferred between the debtor and defendant.[12] For example, the Hopgood firm in *In re Fabric Buys of Jericho, Inc.* had no direct relationship to the opposing party. It merely accepted the funds on behalf of its client with whom that party had dealt directly. The court clearly states: "Hopgood acted as the agent of Unitrac (the client), a mere conduit of funds from Fabric Buys to Unitrac,..."

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[11] Generally, these courts have started at the "bottom line" and worked backwards. If the defendant seems "innocent" then courts are reluctant to find that entity is an "initial transferee." The unfortunate result of accepting this as the premise from which the logic flows, is that the court must first evaluate a defendant's innocence. Some courts have done this, found that the defendant acted in bad faith and thus very comfortably held that defendant liable as an initial transferee. *See, In re Harbour,* 845 F.2d 1254, 1257 (4th Cir. 1988); *In re Musurlian*, 97 B.R. 985, 989 (Bankr. W. D.Wisc. 1989)[;] *see also, In re Baker & Getty Financial Services, Inc.*, 98 B.R. 300, 310 (Bankr. N.D.Ohio 1989); *In re Cash Currency Exchange, Inc., supra.* These courts, effectively, have grafted a new requirement of good faith onto the language of the Code in § 550(a). Only § 550(b) requires an evaluation of the good faith of the mediate transferee. Had Congress intended this to be part of a § 550(a) analysis it could have and would have incorporated that language.

[12] *In re Moskowitz,* 85 B.R. 8, 11 (D.N.Y. 1988) tacitly endorses this theory. The distinction, of course, goes only to determining whether an agency relationship exists. It is unrelated to whether the underlying cause of action is based upon a fraudulent conveyance or preference theory. Clearly, a necessary prerequisite to recover on a preference is the existence of an antecedent debt. One must distinguish, however, between prevailing on the underlying cause of action and analyzing who is a transferee from whom the trustee or debtor can recover.

In re Fabric Buys of Jericho, supra at 337. That court emphasized that the law firm had no direct dealings with the debtor. "Here, Unitrac (the client) had the direct business dealing with Fabric Buys that gave rise to the debt, subsequent suit, and the allegedly preferential payment." *Id.*

In *In re Black & Geddes, Inc.* it was undisputed that the bill of lading was issued by the common carrier, the principal. The debtor and the steamship agency had no direct relationship. The obligation for the freight due ran between the debtor and the principal, the common carrier. It is noteworthy that as part of its defense, the agency invoked classic agency principles. It asserted that it was the agent of a disclosed principal and thereby relieved of liability.

In *Bonded Financial Services* the defendant bank had no direct relationship to the debtor. Its officer Ryan did. The Debtor, however, directed that the funds be paid to Ryan's account. He, in turn, applied them to the loan. The *Bonded* court in its opinion, which is most frequently cited, recites basic agency law. "When A gives a check to B as agent for C, then C is the 'initial transferee'; the agent may be disregarded." *Bonded Financial Services, supra* at 893. It is significant that the *Bonded* court refused to apply section 105 to avoid a so-called inequitable result. This Court opines, and will demonstrate below, that if one applies basic agency principles one need not look to section 105.

In re Chase & Sanborn Corp. also involved facts where no "direct contractual or creditor-debtor relationship" existed between the defendant and the debtor (until the overdraft was created by the lapse in time [24 hours] between when the bank honored the check and when the funds were available to pay it). Prior to this the defendant bank was no different than the defen-

dants in either *In re Columbia Coffee Co., Inc.* or *Bonded Financial Services, Inc.* The quote from Judge Cardozo cited by the *In re Black & Geddes* court both highlights and corroborates this Court's conclusion:

> [T]he person to be charged with liability if he has parted before the bankruptcy with title and possession, must have been more than a mere custodian, intermediary or conduit between the bankrupt and the creditor. Directly or indirectly, he must have had a beneficial interest in the preference to be avoided, the thing to be reclaimed. *Id.* at 875, *citing Carson v. Federal Reserve Bank,* 254 N.Y. 218, 235-236, 172 N.E. 475 (1930).

Finally, even the "dominion and control test," as formulated by the *Bonded* court, has some foundation in agency law. "In determining whether an agency relationship exists between parties to a business enterprise, which is the subject of an agreement between them, the right to control is an important factor." *Nichols v. Arthur Murray, Inc.,* 248 Cal.App.2d 610, 56 Cal.Rptr. 728, 731 (1967) citing *City of Los Angeles v. Vaughn,* 55 Cal.2d 198, 201, 10 Cal.Rptr. 457, 358 P.2d 913; *Malloy v. Fong,* 37 Cal.2d 356, 370, 232 P.2d 241; *Burlingham v. Gray, supra,* 22 Cal.2d 87, 94, 99-100, 137 P.2d 9; *Robinson v. George,* 16 Cal.2d 238, 243-244, 105 P.2d 914; *Anderson v. Badger, supra,* 84 Cal.App. 2d 736, 741, 191 P.2d 768. "If, in practical effect, one of the parties has the right to exercise complete control over the operation by the other an agency relationship exists; the former is the principal and the latter the agent." *Nichols v. Arthur Murray, Inc., supra,* citing *Pacific Lbr Co. v. Ind. Acc. Com., supra*, 22 Cal.2d 410, 415, 138 P.2d 892; *City of Los Angeles v. Vaughn, supra,* 55 Cal.2d 198, 201, 10 Cal.Rptr. 457, 358 P.2d 913.

This Court concludes that the concept of "conduit liability" can be disposed of and "transferee" may be defined by utilizing simple agency principles with all its ramifications and nuances. This conclusion, while seemingly simplistic, obviates the need for the convoluted analyses which have resulted from both the "innocent conduit" theory and the need to invoke the Court's "equitable powers under section 105(a)... to prevent an inequitable result." *In re Fabric Buys of Jerico, Inc., supra* at 337. This is not new law, but is consistent with the concepts already propounded by the courts thus far, regardless of the label they have attached to them.

In light of the foregoing, this Court must analyze the facts of this case to determine whether Schwab and the other discount brokerage houses are transferees or merely agents within the ambit of 11 U.S.C. § 550. It is undisputed that Schwab and other defendants held shares in "street name." Accordingly, Kaiser's records would indicate that Schwab was the shareholder of record. Kaiser had no information as to who the true owner was or whether anyone other than Schwab owned the shares. In addition, the affidavits of Schwab indicate that Schwab generally held the shares in street name only for the benefit of the customers, the beneficial owners. Implicit in the use of the word "generally" is that there are some occasions when Schwab trades on its own account. In those instances Schwab is the principal, and not merely an agent for a beneficial owner. Regardless, in Kaiser's eyes, it contracted with Schwab, its records indicate Schwab is the record owner, Kaiser disbursed funds to Schwab on an unrestricted basis, and Kaiser sued Schwab as the transferee of the funds.

Schwab, on the other hand, has raised its agency status as a defense. Schwab pleads that it is merely an agent of the beneficial owners, its customers, the principals.[13] Kaiser knows that it is a discount brokerage house and that, as a general matter, it does not trade for its own accounts and does not render investment advice. Kaiser, therefore, has some knowledge of that agency and Schwab should be relieved thereby of liability.

This Court is not persuaded. It is hornbook law, which hardly needs repeating, that if a party enters into a contract in his own name and receives the benefits of that contract in his name, he is liable for any obligations arising out of the transaction. This is true even if he is, in fact, not acting for his own account but is acting for the account of some undisclosed principal. *Accord, Cunningham v. Robinson,* 196 Cal. 672, 239 P. 313 (1925); *Craig v. Buckley,* 218 Cal. 78, 21 P.2d 430 (1933); *Wedge v. Security-First National Bank of Los Angeles,* 219 Cal. 113, 25 P.2d 411 (1933); *G.W. Andersen Construction Co. v. Mars Sales,* 164 Cal.App.3d 326, 210

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[13] The Margin and Short Account Agreements entered into between Schwab and its customers contains a clause which reads as follows:

> A pledge of securities and other property.
>
> You are hereby authorized on any amount due in my account, without regard to whether you have in your possession or subject to your control at the time thereof other securities or property of the same kind and amount, to pledge and repledge all securities and other property now or hereafter held, carried, or maintained by you in your possession in any of my accounts, or any part thereof, either separately or together with securities and any other property of other customers, either for the amount due you from me or for a greater sum. (Emphasis added).

Thus Schwab could act as a principal with respect to these securities by virtue of having the securities in its name and pursuant to the beneficial owner's authorization.

Cal.Rptr. 409 (1985). Also, in classic agency theory, unless otherwise agreed a person purporting to make a contract with another for a partially disclosed principal is a party to the contract and bound thereto as a principal. *Cunningham v. Robinson, supra, citing Restatement (Second) of Agency,* § 321. The principal is partially disclosed if the other party has notice that the agent is or may be acting for a principal but has no notice of the principal's identity. *G.W. Andersen Construction Co. v. Mars Sales, supra, citing Restatement (Second) of Agency* § 4(2). Thus, even if this Court accepts Schwab's argument that Kaiser knew that Schwab was a discount brokerage house and that it "generally" did not trade on its own account, the strict application of agency law requires knowledge of the identity of the principals and not just the fact of the agency.

Schwab and the other similarly situated defendants urge this Court to apply its equitable powers under 11 U.S.C. § 105 to limit Kaiser's recovery from them. This Court concurs with the language of the *Bonded Financial* court cited above and the cases cited therein. Specifically, this Court finds the language of *In re Robinson Bros. Drilling, Inc.*, 97 B.R. 77, 82 (W.D. Okla. 1988) apt:

> The equitable powers of the bankruptcy court under section 105 to avoid strict construction of the Code is limited. *Official Comm. of Equity Security Holders v. Mabey,* 832 F.2d 299, 302 (4th Cir. 1987), *cert. denied,* ___ U.S. ___, 108 S.Ct. 1228, 99 L.Ed.2d 428 (1988) (quoting *In re Chicago Milwaukee, St. Paul & Pacific R.R.,* 791 F.2d 524, 528 (7th Cir. 1986), *cert. denied,* 481 U.S. 1068, 107 S.Ct. 2460, 95 L.Ed.2d 869 (1987) ("the fact that a proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, how-

ever, enlightened those views may be"); *Guerin v. Weil, Gotshal & Manges,* 205 F.2d 302, 304 (2nd Cir. 1953).

However enlightened this Court believes its views to be, section 105 is not available to redistribute the rights of the parties according to the judge's views.

Moreover, when one views the facts of this case from the perspective of agency law, the need to avoid inequity is no longer a concern. Clearly, at state law, no inequity results when an agent acts for a principal and enters into a contract without disclosing that relationship and then is found liable on that contract as a principal. As record owner of the shares, Schwab tendered the shares, albeit of its customers, to Kaiser and Kaiser paid the LBO cash consideration to Schwab in response thereto. Thus Schwab was a "transferee" of the funds within the meaning of 11 U.S.C. § 550(a) and is answerable as a result.[14]

Finally, if it could invoke its equitable powers, this Court would refuse to do so where adequate remedies are available at law. Schwab, if found liable, can recover from its customers, its principals.

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[14] While not before this Court at this time, this seemingly simplistic analysis might require that the clearing houses and nominees, who always conduct business in their own names and have not disclosed their principals, be found liable as transferees. A statutory exception, however, is available to them by section 8-320 of the Uniform Commercial Code. To reiterate, this is not before the Court at this time, but the Court raises this only to demonstrate the soundness of the theory which it concludes is best applied to these cases.

V. SECTION 546(e) ANALYSIS

The Bear Defendants urge this Court to apply 11 U.S.C. § 546(e) to limit the trustee's powers to avoid recovery of transfers to brokerage houses only upon a showing of actual fraud under section 548(a)(1). Section 546(e) states:

> Notwithstanding sections 544, 545, 547, 548(a)(2) and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title. (Emphasis added).

While this Court was unable to find any case law specifically applying or interpreting this provision, it is inclined to agree with the Bear Joinder defendants that section 546(e) has general applicability to bankruptcy cases and is not limited to cases where the debtor is a stockbroker or commodities broker as urged by the Debtor. The legislative history of section 546 clearly supports this conclusion. Section 546(e), previously (d), was enacted in 1982 contemporaneous with the repeal of section 764(c). Section 764(c) was among the provisions of Subchapter IV of Chapter 7 which apply only to a case filed by a commodity broker. 11 U.S.C. § 103. Section 764(c) sheltered margin payments and other deposits from the avoiding powers of the trustee except where the trustee or debtor could prove actual fraud under section 548(a)(1). This section was intended to facilitate and protect transactions made in the ordinary course of business in the market. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 391-92. The

legislative history further explains that section 746(c) was repealed and incorporated into section 546(c) for clarification. H.R. Rep. No. 97-420, 97th Cong. 2d Sess. 5 (1982).

The language of section 546(e), formerly (d), now includes "settlement payments." The legislative history notes:

> [T]he provisions apply to margin or settlement payments made by any debtor whether or not such debtor is a commodity broker. The new section 546(d) reiterates and clarifies the provisions of current section 764(c). The new section also encompasses both stockbrokers and securities clearing agencies. Thus, it has been placed among the general provisions in chapter 5 of title 11, rather than among the commodity broker provisions of subchapter IV of chapter 7. 128 Cong. Rec. S8132-3 (daily ed. July 13, 1982) (remarks of Sen. Dole). (Emphasis added).

The critical question then becomes, is the LBO Consideration a settlement payment as contemplated by the language of section 546(e)? Of course, Schwab argues that the LBO Consideration is a settlement payment and Kaiser argues that it is not.

Section 741(8) defines "settlement payment" rather circularly. It states:

> "Settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.

This definition is not particularly enlightening.

Only two courts have attempted to interpret section 741(8). *In the Matter of Bevill, Bresler & Schulman Asset Management Corporation v. Spencer Savings & Loan Association, et al.*, 878 F.2d 742 (3rd Cir. 1989[)];[15] *In re Bevill, Bresler & Schulman, Inc.*, 94 B.R. 817 (D.N.J. 1989). The *Bevill* District court, as noted by the Third Circuit, "looked at definitions of 'settlement' applicable to orthodox corporate securities transactions between a stockholder and a customer." *In the Matter of Bevill, Bresler & Schuman Asset Management Corp., supra,* 878 F.2d at 750. Specifically, the *Bevill* District Court, quoting its earlier unpublished opinion, explained the concept of "settlement" as follows:

> The term "settlement" has a well recognized meaning in the securities industry. As stated in the New York Stock Exchange's The Language of Investing Glossary (1981) at page 30, "settlement" is the
>
> > [c]onclusion of a securities transaction when a customer pays a broker/dealer for securities purchased or delivers securities sold and receives from the broker the proceeds of a sale.
>
> Trades customarily settle within five business days of being executed:

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[15] The precise questions certified in this appeal related to section 546(f), dealing with repurchase agreements and federal government securities. The court mentioned the "unique character of the settlement process in government securities repo transactions." Thus the ultimate holding of this case has no particular applicability here. The court's analysis of the concept of settlement payment, however, is instructive.

> On settlement day, which is normally five days after a trade is executed, the seller's broker is supposed to deliver the bonds or stock certificates to the buyer's broker. If delivery is not made on time the first broker has a "fail to deliver" item. It should be noted that fails occur only between brokers—the failure of the selling customer to hand over to his broker the stock which he sold is not classified as a fail-to-deliver.
>
> N. Wilson, Philips and T. Russo, Regulations of Brokers, Dealers and Securities Markets (1977), at page 6-13, not[e] 28.

In the Matter of Bevill, Bresler & Schulman, Inc. v. Spencer, et al., supra at 829, citing Saul Cohen, Trustee v. Spencer Savings & Loan Association, Civ. No. 87-1154 (D.N.J. October 11, 1988) (transcript of opinion).

The *Bevill* District Court found the payment at issue was not a settlement payment because the delivery occurred outside of five days. The *Bevill* Court of Appeals disagreed with the District [C]ourt and concluded that "'settlement payment' does not only mean payment of cash to the dealer by the purchaser, but also encompasses transfer of the purchased securities to the purchaser from the dealer." *In the Matter of Bevill, Bresler & Schulman Asset Management Corporation v. Spencer, et al., supra,* 878 F.2d at 752. The Circuit Court commented:

> It is well understood in the securities market that the settlement process does not end with the purchaser's payment for the securities; rather, the process continues on to include the record transfer of the securities. Section 17A(a) of the Securities Exchange Act of 1934 ("1934 Act") 15 U.S.C.

§ 78q-1(9), mandating the establishment of a national securities clearance and ("1934 Act") 15 U.S.C. § 78q-1(9), mandating the establishment of a national securities clearance and settlement system, specifically recognizes that the transfer of record ownership of securities is an integral element in the securities settlement process. . . . *Id.* at 751.

The Bear Defendants cite to these cases as authority for its position. Kaiser, on the other hand, relies on one commentator who describes the settlement process as follows:

Normally a buyer places an order through his broker to purchase a certain number of shares of a particular stock for a given price. The buying broker dealer and the selling broker dealer then agree on the trade terms, e.g., security, number of shares and price, and confirm the existence of a contract that is then scheduled for settlement at a clearing agency. This is called trade comparison.

These trade comparisons occur at the exchange, at a clearing agency on behalf of an exchange, or a combination of both. The trades are reported to clearing agencies, e.g., NSCC. Trades are then cleared and settled through a clearing corporation, e.g., DTC, which notes its member broker-dealer's settling purchases and sales in each security to arrive at daily net settlement obligations. The broker-dealers then settle those net obligations with the clearing corporation, which guarantees the settlement obligations of its members broker-dealers with those broker-dealers' counter trading parties. Security deliveries are then generally made automatically between NSCC and its members through debits and credits on their accounts and the DTC accounts. The money settlement is made by certified check. This all occurs within five days of

> the date when the customer places its buy or sell order. Kaiser Brief (March 6, 1989) at pg. 12-13, citing from Division of Market Regulation, U.S. Securities and Exchange Commission, The October 1987 Market Break 10-1 through 10-5 (1988).

From all of the foregoing this Court gleans that a settlement payment contemplates the consummation of an isolated trade between a customer and dealer for cash in the ordinary course of the brokerage industry.

A mandatory redemption of stock as part of this LBO is significantly different from a securities trade. The "exchange" of shares in this case, for both cash and securities, occurs in response to a corporate dictate and has global implications. It affects all shareholders. Schwab is just one of a class involved in this "exchange" of shares for shares and cash. The Proxy Statement and Prospectus furnished in connection with the solicitation of proxies for the Annual Meeting of Stockholders at which the LBO was approved provides:

> Upon the Merger, each outstanding share of Common Stock will be converted into the right to receive $22.00 in cash plus one share of Series A Preferred Stock, $1 par value..., and one share of Series B Preferred Stock, $1 par value..., of the Surviving Corporation.... Proxy Statement and Prospectus, p. 1. (Emphasis added).

It further provides:

> As soon as practicable after the Effective Time, the Surviving Corporation will mail to each holder of record of Common Stock, a letter of transmittal (together with instructions) with

which such stockholder can effect the exchange of his Common Stock certificates for cash and certificates evidencing the number of shares of New Preferred Stock to which he is entitled. Promptly after receipt of such letter of transmittal and instructions, each such holder should send to the Disbursing Agent a properly executed letter of transmittal and all the certificates, in proper form for transfer, evidencing his shares of Common Stock. Upon receipt of the letter of transmittal and such certificates, the Disbursing Agent will mail to the holder or his transferee a check, in an amount equal to $22.00, without interest, for each share represented by such stock certificates, a certificate representing the shares of Series A Preferred Stock to which the holder is entitled, and a certificate representing the shares of Series B Preferred Stock to which the holder is entitled. No dividends will be paid on shares of New Preferred Stock unless share certificates for the corresponding Common Stock have been received by the Disbursing Agent.

As soon as practicable after the Effective Time of the Merger, the Disbursing Agent will disburse to the holder of each 1982 Stock Option the amount of cash and certificates representing the number of shares of Series A Preferred Stock and Series B Preferred Stock that the holder of such 1982 Stock Option has the right to receive.

Clearly no trade comparison is made. The shares are tendered in exchange for cash and securities—at a set price with the number necessarily predetermined by what the shareholder owns. It is mandatory that the shares be physically tendered. It is not merely a bookkeeping entry at a clearing house, the method of delivery focused upon by the *Bevill* court in defining "settlement".

This Court thus finds that the LBO Consideration was not a "settlement payment" as defined in 11 U.S.C. § 741(a) and, therefore, that 11 U.S.C. § 546(e) does not apply to limit Kaiser's recovery from the various stockholders such as Schwab, or others for that matter. This conclusion is not inconsistent with the Third Circuit's decision. In fact, its opinion both supports and guides this Court's decision. The definition of "settlement" propounded is the same and its admonishment to view the transaction as a whole has been heeded. When one views this transaction, the consummation of the LBO, whether in whole, or even in part for that matter, it is clearly distinguishable from the concept of "settlement" subscribed to by that court.

VI. CONCLUSION

This Court finds that Schwab and the other brokers who have joined in the Schwab Motion may be held liable as initial transferees for funds received by them in payment for Kaiser shares held by the broker in street name for its customer. They cannot assert the defense of their agency where the identity of the prin-

cipals, their customers, was undisclosed to Kaiser. Accordingly, summary judgment is DENIED as to these defendants.[16]

DATED: September 25, 1989

BY THE COURT:

/s/ Charles E. Matheson
Charles E. Matheson, Chief Judge

[16] As mentioned above, although Securities Settlement Corporation, a clearing agent, filed a joinder brief, this order goes specifically to the Schwab-type defendants. The nominees and clearing houses have reserved the right to, and may, file their own motion for summary judgment.

APPENDIX C

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

In re:	)	Bankruptcy No. 87 B 1552 E
	)	(Jointly Administered)
KAISER STEEL CORPORATION,	)	
	)	
Debtor(s).	)	
	)	
KAISER STEEL CORPORATION,	)	Bankruptcy Court Adversary
	)	No. 87 E 137
Plaintiff,	)	
vs.	)	
	)	District Court Action
IRWIN L. JACOBS, et al.,	)	No. 88 K 1874
	)	
Defendants.	)	

ORDER

This Court having determined for purposes of judicial economy that the above captioned adversary proceeding ought to be tried in this Court and for good cause shown, it is therefore

ORDERED that pursuant to the provisions of 28 U.S.C. § 157(d), the Court does hereby withdraw its standing Order of Reference No. 1984-3 with respect to the above-captioned adversary proceeding now pending in the United States Bankruptcy Court for the District of Colorado, Adversary No. 87-E-137. Subject to the further orders of this Court all further proceedings in said matter will be conducted in the United States District Court for the District of Colorado and all pleadings, motions or other

documents pertaining to this proceedings should be filed with the Clerk of this Court.

DATED: September 28, 1989

BY THE COURT:

/s/ John L. Kane Jr.
John L. Kane, Jr., Judge

APPENDIX D

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

In re:	)	
	)	
KAISER STEEL CORPORATION,	)	Case No. 87 B 1552 E
	)	(Jointly Administered)
Debtor(s).	)	
	)	
KAISER STEEL RESOURCES, INC., formerly known as KAISER STEEL CORPORATION,	)	Bankruptcy Court Adversary No. 89 E 154
	)	
Plaintiff,	)	
vs.	)	District Court Action No. 88 K 1874
A.G. BECKER, INC., et al.,	)	
	)	
Defendants.	)	

ORDER

This Court having determined for purposes of judicial economy that the above captioned adversary proceeding ought to be tried in this Court and for good cause shown, it is therefore

ORDERED that pursuant to the provisions of 28 U.S.C. § 157(d), the Court does hereby withdraw its standing Order of Reference No. 1984-3 with respect to the above-captioned adversary proceeding now pending in the United States Bankruptcy Court for the District of Colorado, Adversary No. 89-E-154. Subject to the further orders of this Court all further proceedings in

ject to the further orders of this Court all further proceedings in said matter will be conducted in the United States District Court for the District of Colorado and all pleadings, motions or other documents pertaining to this proceedings should be filed with the Clerk of this Court.

DATED: September 28, 1989

BY THE COURT:

/s/ John L. Kane Jr.
John L. Kane, Jr., Judge

APPENDIX E

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action Nos. 88-K-1874, 89-K-1731
Bankruptcy Case No. 87 B 1552 E

In re KAISER STEEL CORP., et. al.,

Debtor.

KAISER STEEL RESOURCES, INC.,

Plaintiffs,

v.

IRWIN L. JACOBS, et. al.,

Defendants.

ORDER ON MOTIONS TO VACATE OR
FOR LEAVE TO APPEAL BANKRUPTCY COURT
ORDER DENYING MOTION FOR SUMMARY
JUDGMENT AND REQUEST FOR HEARING

KANE, J.

On September 25, 1989, the bankruptcy court entered an order denying the motion for summary judgment filed by Charles Schwab & Co. in the above adversary action. Other defendants in

this action joined in the motion, each alleging that it was merely a conduit for the proceeds of the 1984 leveraged buy out of Kaiser and that it therefore had no liability to Kaiser for this transaction.

These defendants now appeal the bankruptcy court's ruling on two grounds. First, they contend that the bankruptcy court had no jurisdiction to enter its order because, on September 19, 1989, I issued my ruling from the bench withdrawing the reference in the Jacobs case and three other related cases. A written order withdrawing the reference was not entered until September 28, 1989. They also argue that the bankruptcy court's ruling denying the motion for summary judgment was incorrect on the merits and therefore move for leave to appeal under 28 U.S.C. § 158(a).

Bankruptcy Rule 9021 states that, "[e]xcept as otherwise provided [in the Bankruptcy Rules], Rule 58 F.R.C.P. applies in cases under the Code. Every judgment entered in an adversary proceeding or contested matter shall be set forth on a separate document. A judgment is effective when entered as provided in Rule 5003...." Furthermore, proceedings in the bankruptcy court are not automatically stayed by an appeal to the district court. *See* Bankr. R. 8005. Consequently, the bankruptcy court had the jurisdiction to enter its order denying the motion for summary judgment; this court's order withdrawing the reference was not effective until set forth on a separate document and filed with the clerk. The requirements of Rule 58 must be applied "mechanically." United States v. Indrelunas, 411 U.S. 216, 220-21 (1973); cf. First Interstate Bank of Denver, N.A. v. Werth, 58 Bankr. 146, 148 (D. Colo. 1986). The motions to vacate the bankruptcy court's order as void for lack of jurisdiction are DENIED.

The defendants' contention, however, that denial of their motions for summary judgment presents an issue appropriate for in-

terlocutory review is well taken. Whether the defendants should be relieved of liability in the Jacobs action because they were mere conduits is a controlling issue of law, subject to differing opinions. Moreover, resolution of this issue will materially advance the litigation before this court. See First Interstate Bank, 58 Bankr. at 148. Consequently, the motions for leave to appeal are GRANTED.[1]

The appellants shall file an opening brief on or before November 14, 1989. A response brief shall be filed on or before December 4, 1989. Oral argument in this matter is set for 9:30 a.m. on January 9, 1989, in Courtroom C-203. Briefs and other papers in this matter shall be filed under Civil Action No. 89-K-1731.

Dated this 25th day of October, 1989, at Denver, Colorado.

/s/ John L. Kane Jr.
JOHN L. KANE, JR.
U.S. SENIOR DISTRICT COURT JUDGE

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[1] Kaiser has filed a motion for clarification, or in the alternative, for extension of time to file answers to motions for leave to appeal. This motion is granted. I have considered Kaiser's answer in opposition to motions challenging the bankruptcy court's summary judgment order, filed October 18, 1989, in reaching this disposition.

APPENDIX F

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 89-K-1731
Bankruptcy No. 87 B 1552 E

In re KAISER STEEL CORP., et. al.,

Debtor.

KAISER STEEL RESOURCES, INC.,

Plaintiff,

v.

IRWIN L. JACOBS, et. al.,

Defendants.

MEMORANDUM OPINION AND ORDER

KANE, J.

This is an appeal from the bankruptcy court's September 25, 1989, ruling denying the motion of Charles Schwab & Co., Inc. for

summary judgment in the Jacobs[1] action. There were no disputed issues of fact. Schwab argued that it was entitled to summary judgment because it was a mere conduit in the stock redemption transactions which occurred as part of the 1984 leveraged buyout of Kaiser. Other parties joining in the motion argued that the payments Schwab received were "settlement payments" exempt from recovery under 11 U.S.C. § 546(e). The bankruptcy court denied the motion, finding that Schwab could be held liable under common-law agency principles and holding § 546(e) inapplicable. On October 25, 1989, I granted leave to appeal this interlocutory ruling. After examining the briefs and listening to oral argument, I reverse the bankruptcy court's ruling.

There are three issues raised by this appeal. First, can Schwab be required to turnover [sic] proceeds from an allegedly fraudulent conveyance as an "initial transferee" under 11 U.S.C. § 550(a)(1)? Second, even if Schwab can be considered [an] initial transferee, is it nevertheless protected by 11 U.S.C. § 546(e), which exempts "settlement payments" made to brokers from recovery as a fraudulent conveyance? Third, in the absence of a clear interpretation of §§ 550(a)(1) and 546(e), do common-law agency principles require that Schwab be held liable for these transactions?[2] These issues are discussed below.

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[1] Kaiser Steel Resources, Inc. v. Jacobs, No. 87-E-137 (Bankr. D. Colo. Feb. 27, 1987).

[2] A number of parties have filed briefs in this appeal. Schwab's brief addresses whether it can be held to be an initial transferee under § 550 and whether agency law applies to this determination. Bear Stearns & Co., Inc. (with other parties) has briefed the issue of the § 546(e) exception for settlement payments. The brief of Chemical Bank (with other parties) analyzes whether there was a contractual relationship between Kaiser and Schwab for the purposes of holding Schwab

(continued)

I. Facts.

A. The 1984 Leveraged Buy-Out.

In 1984, the Kaiser Steel Corporation entered into a merger agreement with the Kaiser Acquisition Corporation (KAC), a Delaware corporation owned by Equivest Associates, a partnership. Under the merger agreement, the KAC acquired ownership of all of the outstanding common stock of Kaiser. In exchange, the stockholders of Kaiser received $22.00 per share of common stock, plus one share of Series A and one share of Series B preferred stock.

Kaiser prepared a prospectus and proxy statement outlining the terms of the proposed merger. At a shareholders meeting on January 18, 1984, the Kaiser shareholders approved the merger. Upon the filing of the merger agreement with the Delaware Secretary of State on February 29, 1984, the merger became effective. Kaiser Steel Corporation merged with KAC and became a Delaware corporation.

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[2] *(...continued)*

liable as an agent for an undisclosed or partially disclosed principal. The Stephens Group, Inc. has filed a short brief, adopting many of the arguments of the above parties. The SEC has likewise filed a brief in this appeal, outlining the mechanics of the stock settlement process, the functions of a clearinghouse and the ramifications of an affirmance of the bankruptcy court's order on the stock clearance and settlement system. The SEC is entitled to participate in this action under 11 U.S.C. § 1109(a), which permits the SEC to "raise and . . . appear and be heard on any issue" in a chapter 11 case. Finally, Kaiser has filed a brief defending its position in this appeal.

B. The Redemption of Kaiser Stock.

Kaiser contracted with the Bank of America to act as its disbursing agent to effect the redemption of Kaiser stock during the LBO/merger. Bank of America was authorized to receive the redeemed stock and to distribute the cash payments and newly issued preferred stock to shareholders. At the time of the redemption, Kaiser did not know who owned its common stock.

Some of the Kaiser's stock was owned by customers of Schwab. Schwab used the services of the Depository Trust Company (DTC) to effect the redemption of its customers' stock. DTC is a settlement and clearing agency for stock transactions registered under the Securities Exchange Act of 1934. DTC and other securities clearinghouses enable financial organizations such as Schwab to transfer and pledge securities on behalf of their customers by means of computerized bookkeeping records without physically transferring the securities. DTC also retains physical custody of stock certificates on behalf of its clients. Certificates for registered securities deposited with DTC are held in the name of Cede & Co., DTC's holding company.

As a participant in DTC, Schwab registers its customers' securities in a nominee name, or "street name," in this case in the name of Schwab & Co., Inc. Use of the nominee or street name registration permits DTC to record the transfer of stock between participants' customers by book entry, without the need to change the registration on the issuer's books in order to transfer the securities. Instead, the transferor's account with DTC is simply debited and the transferee's is credited.

For the redemption of its customers' Kaiser stock, Schwab instructed DTC to surrender the Kaiser shares held for Schwab's customers in the name of Cede & Co. to the Bank of America.[3] Upon receipt of the proper documentation, Bank of America distributed the cash and preferred stock to DTC. DTC then credited the funds to the National Securities Clearing Corporation (NSCC), Schwab's sponsor in DTC.[4] Schwab then credited its customers' accounts.

It is undisputed that, at the time of the merger, Schwab held no Kaiser stock for its own benefit. It is likewise undisputed that Schwab provides no investment advice to its customers, that it did not advise its customers on the merits of the LBO, and that it received no compensation for any services relating to the redemption. Schwab followed the instructions of its customers concerning the voting of their shares with respect to the approval of the LBO; some were voted for the transaction, and some against it. Schwab's form agreements with its customers provide that all securities and money held in Schwab accounts are subject to a lien for the discharge of customer indebtedness to Schwab. Some types of account agreements permit Schwab to pledge securities in Schwab's possession to secure amounts due from customers.

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[3] Schwab also tendered 3,623 shares directly to the Bank of America, principally because the DTC ceased handling transfers of Kaiser stock during the time between the shareholders approval of the merger and the actual redemption date.

[4] NSCC is also a clearing agency registered with the SEC. Schwab is a participant in NSCC, and NSCC is a member of DTC.

C. The Jacobs Action.

Kaiser filed the Jacobs action in February of 1987. Jacobs is a fraudulent conveyance action under the "strong arm" clause of § 544(b) of the Bankruptcy Code. That section provides:

> The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

11 U.S.C. § 544(b). The strongarm [sic] clause grants Kaiser the rights of a hypothetical creditor. Kaiser must bring this action under § 544(b) rather than under the Bankruptcy Code's own fraudulent conveyance provision, 11 U.S.C. § 548, because § 548 applies only to fraudulent transfers made within one year of the filing of the bankruptcy petition. (The stock redemption in this case occurred outside of the one-year period).

In Jacobs, the "applicable law" under § 544(b) is California's fraudulent conveyance statute, Cal. Civ. Code § 3439.04, .05, .06 (1985), which parallels sections 4, 5 and 6 of the Uniform Fraudulent Conveyance Act. Under this statute, a conveyance can be set aside if (1) the transferor received less than fair consideration and was insolvent or rendered insolvent by the transfer, (2) the transferor was left with an unreasonably small amount of capital with which to operate, or (3) the transferor intended or believed it would incur debts beyond its ability to pay them as they matured. In Jacobs, Kaiser is seeking to recover the $22.00 per share payment made to the common stockholders under each of these theories.

Kaiser initially named 16 defendants in the Jacobs action, consisting of the Jacobs Group (a large shareholder group which had earlier attempted a hostile takeover), DTC, Cede & Co., other clearing agencies and some brokerage firms. After discovery of these defendants, Kaiser amended its complaint, adding approximately 178 additional parties who were primarily banks and brokerage houses.[5] Kaiser subsequently voluntarily dismissed DTC, Cede & Co., the NSCC and other parties from the action.

On June 30, 1988, Schwab moved for summary judgment on the ground that, like DTC and the other clearinghouse defendants, it was a mere conduit in the LBO/merger transaction and therefore could not be held liable for the return of any payments related to the transaction. Other parties joined the motion as a "test case" on the conduit liability issue. Kaiser and Schwab filed a joint, stipulated statement of facts and affidavits, and Kaiser filed a supplemental statement of facts. On September 25, 1989, Judge Matheson denied the motion for summary judgment.

D. The Bankruptcy Court's Ruling.

In its published decision, see In re Kaiser Steel Corp., 105 Bankr. 639 (Bankr. D. Colo. 1989), the bankruptcy court undertook a comprehensive analysis of the issues raised by the Schwab motion. Although it recognized the many court decisions in which mere conduits in a transaction were exempted from an action by the trustee to recover a fraudulent conveyance, see id. at 644-648, it distinguished these cases by concluding that each rested on common-law agency principles. "This conclusion," the court

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[5] In February, 1989, Kaiser filed its complaint in Kaiser Steel Resources, Inc. v. Becker, No. 89-E-154 (Bankr. D. Colo. Feb. 10, 1989). In Becker, Kaiser asserted essentially the same claims as in Jacobs against the former beneficial owners of Kaiser stock who received compensation in the LBO.

stated, "while seemingly simplistic, obviates the need for the convoluted analyses which have resulted from both the 'innocent conduit' theory and the need to invoke the court's 'equitable powers under section 105(a) . . . to prevent an inequitable result.' This is not new law, but is consistent with the concepts already propounded by the courts thus far, regardless of the label attached to them." Id. at 649.

Applying agency law, the bankruptcy court noted that Schwab's registration of its customers' securities in its street name was significant because Kaiser's records would indicate that Schwab was the shareholder of record. Therefore, "in Kaiser's eyes, it contracted with Schwab . . . ." Id. The court went on to conclude that Schwab's capacity was that of an agent for an undisclosed principal, and that under "hornbook law," Schwab was liable for any obligations arising out of the transaction. Id. Finally, the court rejected the Bear Defendant's argument that the payments to Schwab were "settlement payments" under § 546(e) of the Code, finding that the term applied only to "an isolated trade between a customer and dealer for cash in the ordinary course of the brokerage industry." Id. at 652.

II. Issues.

A. Schwab's Liability as an "Initial Transferee" Under Section 550 of the Code.

Section 550(a) of the Bankruptcy Code governs the trustee's (or a debtor in possession's) recovery of a fraudulent conveyance. This section provides:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may

recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.[6]

11 U.S.C. § 550(a) (emphasis added). Thus, in order for Schwab to be liable under § 544 for this fraudulent conveyance, it must be an "initial transferee" under § 550(a) or an immediate or mediate transferee of the initial transferee. In its motion for summary judgment, Schwab claimed that it was not the initial transferee of the LBO consideration but was an innocent conduit in the transaction, as were the commercial clearinghouses who were voluntarily dismissed from the action.

The Bankruptcy Code does not define the term "transferee" or "initial transferee." Consequently, in a struggle to define the term "initial transferee" within its logical limits, courts have excepted

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[6] Section 550(b) limits the trustee's recovery from immediate and mediate transferees of the initial transferee. It provides:

(b) The trustee may not recover under section (a)(2) of this section from—

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 550(b). Section 550(c) further provides that the trustee is entitled to a single satisfaction under subsection (a).

from its scope a party who acts only as "'a mere custodian, an intermediary or conduit between the bankrupt and the creditor'" and who has no beneficial interest in the thing to be recovered. See Salomon v. Nedlloyd (In re Black & Geddes, Inc.), 59 Bankr. 873, 875 n. 4 (Bankr. S.D.N.Y. 1986) (quoting Judge Cardozo in Carson v. Federal Reserve Bank, 254 N.Y. 218, 235-36, 172 N.E. 475 (1930)). The bankruptcy court's opinion below contains a thorough discussion of the development of this doctrine. See 105 Bankr. at 644-48.

In a nutshell, bankruptcy courts, district courts, and courts of appeal have limited the trustee's recovery of funds from banks, law firms, and different industry clearinghouses when these organizations acted solely as intermediaries in the fraudulent transaction. See, e.g., Lowry v. Security Pac. Business Credit, Inc. (In re Columbia Data Prods., Inc.), No. 89-2710 (4th Cir. Dec. 15, 1989) (bank with no direct relationship to debtor not an initial transferee); Nordberg v. Societe Generale (In re Chase & Sanborn Corp.), 848 F.2d 1196 (11th Cir. 1988) (bank which deposited payment from debtor into third party's account not an initial transferee); Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890 (7th Cir. 1988) (same); Metsch v. First Ala. Bank (In re Columbian Coffee Co.), 75 Bankr. 177 (S.D. Fla. 1987) (same); Jet Fla., Inc. v. Airlines Clearing House, Inc. (In re Jet Fla. Sys., Inc.), 69 Bankr. 83 (Bankr. S.D. Fla. 1987) (airline clearinghouse not liable for payment from debtor which it applied to creditor airline's account); Salomon v. Nedlloyd (In re Black & Geddes, Inc.), 59 Bankr. 873 (Bankr. S.D.N.Y. 1986) (steamship company not initial transferee of payment by debtor freight forwarder on obligation to common carrier); Ducker v. Fairmeadows II (In re Bridges Enter., Inc.), 62 Bankr. 300 (Bankr. S.D. Ohio 1986) (law firm acting as conduit of settlement payment not an

initial transferee); Gopper v. UNITRAC, S.A. (In re Fabric Buys of Jericho, Inc.), 33 Bankr. 334 (Bankr. S.D.N.Y. 1983) (same).[7]

Courts have rested this doctrine on two theoretical bases. First, applying a statutory analysis, they have noted that the term "transferee" implies more than just a possessor, holder or agent. "[T]he minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes." Bonded Fin. Servs., 838 F.2d at 893. Thus, in the several circuit court cases examining the issue, a "control test" has emerged. The test requires that the court examine the transaction as a whole to determine whether the recipient of the funds or property "actually controlled the funds or merely served as [a] conduit[]." In re Chase & Sanborn Corp., 848 F.2d at 1200.

To a lesser extent, courts addressing the conduit liability issue have also premised the exception on their inherent equitable powers. As noted by the court in In re Chase & Sanborn Corp., "[t]he control test, then, as adopted by this circuit, simply requires courts to step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable. This approach is consistent with the equitable concepts underlying bankruptcy law." Id. at 1199; see also 4 Collier on Bankruptcy ¶ 350.02 at 550-8 (L. King 15th ed. 1989) ("In some circumstan-

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[7] In several cases, courts have recognized the "mere conduit" doctrine but have declined to apply it because of the bad faith of the transferee or its knowledge of the fraudulent nature of the transaction. See, e.g., Huffman v. Commerce Sec. Corp. (In re Harbour), 845 F.2d 1254, 1257 (4th Cir. 1988); Kepler v. Olson (In re Musurlian), 97 Bankr. 985, 989 (Bankr. W.D. Wis. 1989). There are no allegations in this case that Schwab acted in bad faith or had any culpable knowledge of the allegedly fraudulent conveyance; therefore, this gloss on the "mere conduit" doctrine would not apply.

ces, a literal application of section 550(a) would permit the trustee to recover from a party who is innocent of wrongdoing and deserves protection. In such circumstances the bankruptcy court should use its equitable powers to prevent an inequitable result.") In contrast, the Seventh Circuit in Bonded Financial downplayed the role of equity in its reasoning on the conduit issue, stating,

> We are aware that some courts say that an agent (or a bank in a case like ours) is an "initial transferee" but that the courts may excuse the transferee from repaying using equitable powers. This is misleading. "Transferee" is not a self-defining term; it must mean something different from "possessor" or "holder" or "agent". To treat "transferee" as "anyone who touches the money" and then to escape the absurd results that follow is to introduce useless steps; we slice these off with Occam's Razor and leave a more functional rule.
>
> . . . We mention the problem not to resolve it (for it is not before us) but to show that this appeal to "equity"—to deny recovery against an "initial transferee" within the statute—is different in source and scope from the way in which we have employed considerations of policy to define "transferee" under § 550(a)(1). Doubts about this use of equity do not imply that courts should take "transferee" for all it could be worth rather than for what a sensible policy implies it is worth.

838 F.2d at 894-95 (citations omitted). Regardless of what theoretical basis justifies the limitation of the term "initial transferee" to persons who exercise some degree of control over the funds transferred, it is clear this limitation is judicially recognized.

Applying the control test to this case, the logical conclusion is that Schwab cannot be considered an initial transferee. Schwab's role in the stock redemption was almost identical to that of the securities clearinghouses and related entities who were earlier dismissed from the action. As required by the terms of the merger agreement between Kaiser and KAC, Schwab either directed DTC to surrender its client's shares to the Bank of America for redemption or delivered the shares directly to Bank of America (see note 3). The Bank of America then disbursed the cash payment and preferred stock to DTC, who credited Schwab's NSCC-sponsored account. Schwab, in turn, credited its customers' accounts. Schwab never held a beneficial interest in any Kaiser stock, received no consideration for facilitating the conversion of its customers' stock, and had no ability to control the disposition of funds paid to its customers in the merger. It was simply a financial intermediary, not a "transferee."

Kaiser seeks to establish that Schwab exercised dominion over the funds paid to its customers by referencing certain provisions in Schwab's customer agreements which grant it a lien on assets held by Schwab and by arguing that Schwab had the discretion to vote its customers' stock for or against the merger. As noted by the SEC, however, Commission regulations set strict requirements on a broker's use of customer funds to protect against misuse and abuse. See 17 C.F.R. 240.15c3-3. Schwab's customer agreements provide that the broker's lien and repossession rights are only to secure amounts due Schwab. There is no evidence that Schwab could arbitrarily apply customer funds for its own benefit. Likewise, industry rules require Schwab to vote stock held in street or nominee name only as directed by the beneficial owner. See SEC Reply Brief at 2 (citing New York Stock Exchange Guide (CCH) ¶ 2452). Contrary to Kaiser's suggestion, Schwab may not vote customer stock according to its own desires.

Given that the undisputed facts in this case indicate that Schwab was nothing more than a mere conduit and that Kaiser's attempt to establish Schwab's control over the transferred funds flies in the face of established regulations controlling the broker's action with respect to customer accounts, the bankruptcy court should have concluded that Schwab is not an "initial transferee" under § 550. Nevertheless, the bankruptcy court distinguished the above cases, stating "[i]n no instance where a court finds a defendant to be a "mere conduit" is there a direct creditor/debtor relationship or any other direct contractual relationship specifically related to the funds transferred between the debtor and defendant." 105 Bankr. at 648. It then went on to conclude that, under common law agency principles, Schwab could be held liable as agent for an undisclosed principle. This issue is discussed in Section IIC, below.

B. Applicability of Section 546(e) Exception for Settlement Payments.

As an alternative to § 550, Schwab and other brokers argue that the payments in question are exempt from recovery as a fraudulent conveyance under 11 U.S.C. § 546(e). That section states:

> Notwithstanding sections 544, 545, 547, 548(a) (2), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution or securities clearing agency, that is made before the commencement of the case, except under section 548 (a)(1) of this title.

11 U.S.C. § 546(e) (emphasis added). Section 741(8), in turn, cryptically defines a "settlement payment" as a "preliminary settlement payment, a partial settlement payment, an interim settle-

ment payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). The bankruptcy court ruled that the term "settlement payment" is limited to payments connected with "an isolated trade between a customer and dealer for cash in the ordinary course of the brokerage industry." 105 Bankr. at 652. It then held that the stock redemptions in this case were not ordinary securities transactions and were outside the § 546(e) exception.

Schwab, other brokers, and the SEC argue that the term "settlement payment" should not be so narrowly defined. Three factors support this conclusion. First, the § 741(8) definition itself references "any similar payment commonly used in the securities trade," indicating that the term should be given a reasonably flexible meaning with reference to industry practice.[8] Second, as the appellants note, the only two cases addressing this issue, In re Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Sav. & Loan Ass'n., 878 F.2d 742 (3d Cir. 1989), and In re Blanton,

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[8] For example, in Group of Thirty, Clearance and Settlement Systems in the World's Securities Markets (1989) (a document published by a private sector group concerned with the international financial system and attached as Appendix A to Kaiser's brief), the functions of a central securities depository (such as DTC) are described. Among the customary responsibilities of such a depository is to facilitate "corporate actions" which "generally include public offerings, rights issues, entitlement issues, warrants, tender offers, exchanges, and bonus shares." Id. at 59 (emphasis added). The depository is responsible for transmitting details of corporate action to participant shareholders and then executing shareholder and corporate instructions to adjust the shareholder's position. Id. In the glossary to this publication, the term "settlement" is broadly defined as "[t]he completion of a transaction, wherein securities and corresponding funds are delivered and credited to the appropriate accounts." Id. at 86. Assuming that a corporate merger and redemption of stock is a transaction, this definition would seem to cover the payments at issue in this case.

105 Bankr. 811 (D. Va. 1989), have interpreted the term broadly, albeit in circumstances not germane to this appeal. Finally, as stressed by the SEC, defining the term "settlement payment" to encompass the transfers in this case is consistent with the legislative intent behind § 546(e) to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions. See, e.g., Seligson v. New York Produce Exch., 394 F. Supp. 125 (S.D.N.Y. 1975) (trustee of bankrupt commodities broker sought to recover as a fraudulent conveyance margin payments to a clearinghouse, leading to Congress' enactment of § 546(e) and other provisions to protect commodities and securities brokers and related entities); see also 15 U.S.C. § 78q-1 (providing for the establishment and facilitation of a national system for the prompt and accurate clearance and settlement of securities transactions).[9]

C. Bankruptcy Court's Reliance on Agency Principles to Hold Schwab Liable.

Despite the apparent applicability of conduit and settlement payment exceptions to the recovery of the funds in this case, the bankruptcy court chose to rely on agency principles to find Schwab potentially liable. Specifically, the court reasoned that, because Schwab held its customers' shares in street name,

> Kaiser's records would indicate that Schwab was the shareholder of record. Kaiser had no information as to who the true owner was or whether anyone other than Schwab

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[9] In this case, the DTC held a huge block of Kaiser securities in its nominee name, "Cede & Co." There is little question that were DTC required to refund the payments in this case, it would have a significant effect on the corporation. Since Schwab is in essentially the same position as the DTC (only one step further down the line of conduits), it should receive similar protection.

> owned the shares. In addition, the affidavits of Schwab indicate that Schwab generally held the shares in street name only for the benefit of the customers, the beneficial owners. Implicit in the use of the word "generally" is that there are some occasions when Schwab trades on its own account. In those instances Schwab is the principal, and not merely an agent for a beneficial owner. Regardless, in Kaiser's eyes, it contracted with Schwab, its records indicate Schwab is the record owner, Kaiser disbursed funds to Schwab on an unrestricted basis, and Kaiser sued Schwab as transferee of the funds.

105 Bankr. at 649. The court then concluded that, as an agent for an undisclosed principal, Schwab could be held liable. Id.

There are several problems with this analysis. First, the bankruptcy court incorrectly assumed that Kaiser's records would indicate that Schwab was the record owner of Kaiser stock. As established in uncontroverted affidavits, however, Kaiser stock held by Schwab's customers in street name was actually registered in the name of DTC's nominee, Cede & Co. Consequently, if anything, Kaiser's records would indicate that it was dealing with Cede & Co., not Schwab. Contrary to the bankruptcy court's assumption, it is likewise undisputed that Schwab did not and does not trade Kaiser or other stock for its own account except to correct short-term trading errors, if any.

More importantly, the bankruptcy court's application of agency principles assumes that there is a contract between Kaiser and Schwab, when in fact no contractual relationship was ever formed. The distribution in this case was the result of a corporate merger transaction, not a negotiated contract between Kaiser and Schwab or its customers. The power to merge is derived from a

state's corporation law and controlled by the merger agreement. In this case, when the merger agreement was filed with the Secretary of State of Delaware, the merger became effective and the conversion provisions of the agreement were automatically activated. See generally Shields v. Shields, 498 A.2d 161, 167 (Del. Ch. 1985) (corporate act of merger effects a "transmutation" of the stock interest). Consequently, the bankruptcy court's reliance on contract-based rules of agency law is misplaced.

III. Conclusion.

Although no court has considered whether a stockbroker is an initial transferee from whom a fraudulent conveyance can be recovered under § 550, in a number of other cases courts have found parties acting in similar capacities to be outside the scope of this section. Schwab should not be considered an initial transferee in this case because it exercised no control over the funds it conveyed to its customers and derived no benefit from the transaction. Kaiser's attempt to establish Schwab's dominion over the funds is specious in light of agency and industry regulations limiting Schwab's ability to take the actions alleged by Kaiser. Even if Schwab can be considered an initial transferee, the "settlement payment" exception of § 546(e) should be broadly construed to cover the payments in this case. To hold Schwab and other similarly situated parties potentially liable under these circumstances could have serious consequences on the Congressionally-mandated system for the clearance and settlement of securities transactions. Finally, the bankruptcy court's reliance on agency law to circumvent the above Code sections is questionable at best and

rests on a mistaken understanding of Schwab's relationship with Kaiser in this case.

Dated this 22nd day of January, 1990, at Denver, Colorado.

/s/ John L. Kane Jr.
JOHN L. KANE, JR.
U. S. SENIOR DISTRICT COURT JUDGE

APPENDIX G

APPENDIX G

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 88-Z-1874

In re Kaiser Merger Litigation.

EDITH CITRON, et al, Plaintiffs,

vs.

KAISER STEEL CORPORATION, et al., Defendants.

REPORTER'S TRANSCRIPT

(Hearing on Motions for Summary Judgment)

Proceedings before the HONORABLE ZITA L. WEINSHIENK, Judge, United States District Court for the District of Colorado, commencing at 9:05 a.m., on the 24th day of July, 1990, in Courtroom C-502, United States Courthouse, Denver, Colorado.

APPEARANCES

Coghill & Goodspeed, by G. Stephen Long, Attorney at Law, 1675 Broadway, Denver, Colorado, 80202, and Marty Harper and Jessica Youle, Attorneys at Law, Lewis and Roca, 40 North Central Avenue, Phoenix, Arizona, 85004-4429, appearing on behalf of Kaiser.

Shaw, Spangler & Roth, by Barry L. Wilkie, Attorney at Law,

Proceedings Recorded by Mechanical Stenography, Transcription Produced via Computer by Paul Zuckerman, 1929 Stout Street, P.O. Box 3563, Denver, Colorado 80294, (303) 629-9285

RULING

The Court: I appreciate the arguments made by Counsel, and I think that the arguments and the questions have helped to solidify my thinking on this point of law; and I am prepared to just read my decision into the record at this time, rather than to delay it.

Judge Kane in his decision came to the conclusion that the settlement payment exception of 546(e) should be broadly construed to cover the payments in this case. "To hold Schwab and others similarly situated—" whoops, I'm reading it wrong.

"To hold Schwab and other similarly situated parties potentially liable under these circumstances could have serious consequences on the congressionally mandated system for the clearance and settlement of securities transactions."

Now, that technically is not a holding. That is mere dictum, because his holding was that Schwab was a conduit and therefore not covered by section 550. And then he went on to say that even if they're not a conduit, even if they may be considered an initial transferee; and he went on to the 546 definition.

I do want to make very clear that it is dictum and it isn't law of the case and I'm not bound to follow it. However, I do think that it has some merit to the thought.

The reason for Judge Kane reaching that conclusion, albeit dictum, he set forth, was three reasons: The No. 1 reason he gives is the plain meaning of the statute and the fact that the definition talks about "any similar payment commonly used in the securities trade."

The second reason he gives is the holdings of the cases that we have discussed, and notably the Bevill, et al. case, which have interpreted the term "settlement payment" very broadly, even though in circumstances not relevant to this appeal.

And the last reason is—and perhaps it's just a short sentence. I can read it, on page 16 of his opinion: "Finally,

as stressed by the SEC, defining the term 'settlement payment' to encompass the transfers in this case is consistent with the legislative intent behind 546(e) to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions."

So for those reasons, he reaches the conclusion—and again, I consider it dictum—that 546(e) applies and protects the financial intermediaries.

The case of Bevill, Bresler & Schulman v. Spencer Savings & Loan—I'm not sure we've put the cite on the record. It's 876 F.2d 742, a Third Circuit case, very recent, 1989. In that case, on page 751 of the decision, the court sets forth that there are two important national legislative policies on a collision course. One is the Bankruptcy policy, which gives broad powers to a trustee to avoid transactions taking place within 90 days prior to the petition filing—and that is an extremely important policy; and the other policy, as stated by the Bevill court, is the intent of the 97th Congress to remove the right of the trustee to avoid transactions under certain circumstances.

And the court goes on to say that these amendments, the '82 amendments, were there to ensure that the avoiding powers of the trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud.

The court then in a case which deals with different

facts, deals with the repo situation and not with this leveraged buyout situation, but nevertheless, with different facts, does go on to interpret "settlement payments" very broadly. On page 752 of the opinion, it says, "such an interpretation of settlement payment is consistent—" and they're talking about a broad interpretation "—is consistent with two basic intentions of Congress that a settlement payment may be the deposit of cash by the purchaser or the deposit or transfer of the securities by the dealer, in that it includes transfers which are normally regarded as part of the settlement process, whether they occur on the trade date, the scheduled settlement date, or any other date in the settlement process for the particular type of transaction at hand. Congress would not have found it necessary in the 1982 amendments to provide such an expansive list of possible types of settlement payments in section 741(8) if it intended that all of them would in effect have to have been made on or before a scheduled settlement date in order to qualify under the definition."

So what we have in the one circuit case which deals at least with an issue of whether "settlement payment" should be given a narrow or a broad interpretation is that it is given a broad interpretation.

In considering Judge Kane's dictum, in considering the Third Circuit opinion, and in considering the policy, the plain language of the statute, this court reaches a conclusion that

"settlement payment" must be interpreted broadly and that it does cover the situation here, for the following reasons:

The primary concern of Congress seems to have been to promote the liquidity of participants in the securities industry. And I don't think that it helps to characterize the transaction as open market or closed market.

In this case, I don't agree that Kaiser can say that an LBO or a mandatory stock redemption is like a dividend. A dividend is a one-way transaction. It does not involve a trade. In this case, there was a trade: Stock did go both ways. Contrary to the argument of Kaiser that the stock of old Kaiser didn't have to be tendered, in most cases it was tendered, or a statement that it was lost. And without any question, the preferred stock was being traded; so the preferred stock and the $22 per share did go through the brokers or the financial institutions, and this was a trade. We had the old stock traded for the new preferred stock and the $22.

The argument that Kaiser makes that this opens the door to future horrors, I think, has to be addressed, because although the exception for fraud is not available to the Kaiser trustee and parties, creditors, in this case, because the statute, 548(a), only applies to transfers made or incurred on or within one year before the date of the filing of the petition, in other cases, in future cases, there will indeed be this fraud exception. And if creditors, if trustees act within

the statute of limitations, this certainly is an out. Fraud is an exception to the mandate of 546(e).

The Court, therefore, for all of these reasons, would find as a matter of law, would conclude as a matter of law, that the leveraged buyout mandatory stock redemption payments were settlement payments, or were at least similar to settlement payments; and therefore, the trustee may not recover these payments pursuant to the Bankruptcy Code's avoidance provisions, because these payments are exempt from the trustee's avoidance powers under 11 United States Code section 546(e).

That takes care of the motion that's before the Court at this time. I am going to grant the motion for summary judgment, therefore, of the financial intermediary defendants.

APPENDIX H

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Consolidated Civil Action No. 88-Z-1874

In re Kaiser Merger Litigation

ORDER

WHEREAS, these consolidated proceedings include, inter alia, two adversary proceedings (the "Adversary Proceedings") entitled Kaiser Steel Resources, Inc. v. Irwin L. Jacobs, et al., Adversary No. 87-E-0137 (the "Jacobs Proceeding"), and Kaiser Resources, Inc. v. Action Traders, Inc., et al., Adversary No. 89-E-0154 (the "Action Traders Proceeding"), each of which was commenced in the United States Bankruptcy Court for the District of Colorado and subsequently withdrawn to this Court;

WHEREAS, the following defendants (the "Financial Intermediaries"), moved for summary judgment, pursuant to Rule 56 of the Federal Rules of Civil Procedure, dismissing all the claims asserted against them in the respective Adversary Proceedings on the ground that, inter alia, plaintiff is precluded from recovering payments received by such defendants for, and credited to, the account of another person because they are "settlement payment[s] made by or to a . . . stockbroker, financial institution, or securities clearing agency" for purposes of Section 546(e) of the Bankruptcy Code, 11 U.S.C. § 546(e). Each name is followed by a "J" if the party is a defendant in the Jacobs Proceeding, an "A"

if the party is a defendant in the Action Traders Proceeding, and in each case the number that precedes the party's name in the respective complaint:

A.G. Edwards & Sons, Inc. (J19)
ABD Securities Corporation (J20)*
Advest, Inc. (J21)
Alex Brown & Sons (J22)*
Bank of Montreal (J28)
Bank of New England, N.A. (J29)
Bankers Trust of New York (J33)
Barclays Bank, PLC. (J34), f/k/a Barclays Bank, International Limited
Bear Stearns & Co., Inc. (J36)
Brown Brothers Harriman & Co. (J41)
Burke, Christensen and Lewis Securities, Inc. (J167)
Canadian Imperial Bank of Commerce (A30)*
Chemical Bank (J48)
Citibank, N.A. (J50)
Continental Bank, N.A. (J128)
Dean Witter Reynolds, Inc. (J55)
Deutsche Bank Capital Corp. (J27), f/k/a Atlantic Capital Corp.
Doft & Co., Inc. (J57)
Edward D. Jones & Co. (J63)
Emmett A. Larkin Co., Inc. (J188)
Eppler, Guerin & Turner, Inc. (J65)
Ernst & Company (J66)
Evans & Co., Inc. (J69)

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* This defendant is in the process of withdrawing or has withdrawn its motion for summary judgment due to settlement.

Fahenstock & Co., Inc. and Edward A.
Viner & Co., Inc. (J62 and J70)
Fiduciary Trust Company (J72)*
First Albany Corporation (J75)
Gordon Capital Corporation (J164),
f/k/a Baily Gordon Securities
Herzfeld & Stern n/k/a
JII Securities, Inc. (J13)
Herzog, Heine, Geduld, Inc. (J82)
Hillman Company (J12)
J.W. Charles Securities, Inc. (J172)
Jefferies & Company, Inc. (J88)
Josephthal & Co., Inc. (J11)
Kidder Peabody & Co., Inc. (J92)
Lewco Securities Corp. (J97)
Mabon, Nugent & Co. (J100)
Magna Millikin National Bank of
Decatur, N.A., f/k/a Millikin
National Bank of Decatur (J175)
Manley, Bennet, McDonald & Co. (J101)*
Manufacturers & Traders Trust Company (J102)
Marine Midland Bank, N.A. (J105)
Midland Bank (Princess Street)
Nominees Limited (A129)
Merrill Lynch, Pierce, Fenner & Smith,
Inc. (J108)
Morgan Guaranty Trust Company of New York (J110)
Morgan, Olmstead, Kennedy & Gardner, Inc. (J112)
National Financial Services Corp. (J115)

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* This defendant is in the process of withdrawing or has withdrawn its motion for summary judgment due to settlement.

Northern Trust Company (J177)
Pacific Brokerage Services, Inc. (J121)
Paine Webber, Inc. (J122)
Piper, Jaffray & Hopwood, Inc. (J124)
Prescott, Ball & Turben, Inc. (J125)*
Purcell, Graham & Co. f/k/a
Purcell, Graham & Co., Inc. (J126)*
Rauscher Pierce Refsnes, Inc. (J129)*
Regional Clearing Corp. (J130)
ScotiaMcLeod, Inc. (J113),
f/k/a McCleod Young Weir, Limited
Southwest Securities, Inc. (J144)
Spear Leeds & Kellogg (J146)
Sutro & Co., Incorporated (J149)
Swiss American Securities, Inc. (J150)
Swiss Bank Corporation (J151)
Tucker Anthony Incorporated (J128)
Tweedy Browne Clearing Corp. n/k/a
NB Clearing Corporation (J155)
U.S. Clearing f/k/a Q&R Clearing Corp. (J127)
United States Trust Company of New York (J156)
Wedbush Morgan Securities, Inc. (J112 and J160)
Weiss, Peck & Greer (J161)*
Securities Settlement Corp. (J139)
Financial Clearing & Service (J74)*

WHEREAS, the following defendants (the "Dual Status Defendants") moved for partial summary judgment dismissing all the claims asserted against them in the respective Adversary

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* This defendant is in the process of withdrawing or has withdrawn its motion for summary judgment due to settlement.

Proceedings insofar as plaintiff seeks to recover payments that were received by each such Dual Status Defendant for, and credited to, the account of another person on the ground that, inter alia, plaintiff is precluded from recovering those payments because they are "settlement payment[s] made by or to a . . . stock-broker, financial institution, or securities clearing agency" for purposes of Section 546(e) of the Bankruptcy Code:

Asiel & Co. (J26)
Dillon, Read & Co. Inc. (J56)
Drexel Burnham Lambert Incorporated (J60)**
Flemings North America Inc. (A156),
f/k/a Robert Fleming, Inc.
Goldman, Sachs & Co. (J14)
L.F. Rothschild & Co. Inc. (J93)
Oppenheimer & Co., Inc. (J9)
Oscar Gruss & Son, Inc. (J120)
Royal Bank of Scotland (A161)
Smith Barney, Harris Upham & Co., Inc. (J143)
Stephens Group, Inc. f/k/a Stephens, Inc. (J182)
Wells Fargo Bank, N.A. and Crocker National
Bank (J162, A205, A206 and J52)
Wertheim Schroder & Co., Inc. (A208)

WHEREAS, a hearing was held on July 24, 1990, on all of the aforementioned motions, insofar as they were based on Section 546(e) of the Bankruptcy Code, at which time the Court made conclusions of law which are incorporated herein as if fully set forth;

** This defendant has filed for bankruptcy.

WHEREAS, the Court determined that all of the aforementioned motions would be granted;

WHEREAS, after the Court announced its decision granting the aforementioned motions, it proposed that it would be appropriate to grant summary judgment, sua sponte, dismissing all claims against the Stockholder Defendants, which includes the claims asserted against the Dual Status Defendants in their capacities as Stockholder Defendants, asserted by plaintiff in each of the Adversary Proceedings, other than Irwin L. Jacobs (J1), Daniel T. Lindsay (J2), Dennis M. Mathisen (J3), and Gerald A. Schwalbach (J4) ("the Jacobs Defendants");

WHEREAS, the Court considered the parties' comments concerning the appropriateness of its proposal and the supplemental briefs which were filed on the application of Section 546(e) to the Stockholder Defendants; and

WHEREAS, the Court determines that the granting of the aforementioned motions and the granting of summary judgment, sua sponte, as indicated in the preceding paragraphs disposes of all the claims asserted by plaintiff in the Action Traders Proceeding and all the claims asserted by plaintiff in the Jacobs Proceeding against all defendants other than the Jacobs Defendants, and that there is no just reason to delay the entry of a final judgment;

NOW, for the reasons stated herein and on the record at the hearing on July 24, 1990, it is hereby

ORDERED, pursuant to Rules 54(b) and 56 of the Federal Rules of Civil Procedure, that

1. The Section 546(e) motions for summary judgment and partial summary judgment are granted.

2. The Court hereby grants summary judgment, sua sponte, dismissing all the claims asserted by plaintiff in each of the Adversary Proceedings against all the defendants other than the Jacobs Defendants.

3. The Clerk is directed to enter a judgment in the Jacobs Proceeding dismissing each and every claim asserted by plaintiff against each and every defendant other than the Jacobs Defendants.

4. The Clerk is directed to enter a judgment in the Action Traders Proceeding dismissing each and every claim asserted by plaintiff against each and every defendant.

SO ORDERED.

DATED August 10, 1990 at Denver, Colorado.

/s/ Zita L. Weinshienk
United States District Judge

APPENDIX I

APPENDIX I

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 88-Z-1874

In re Kaiser Merger Litigation

JUDGMENT

Pursuant to and in accordance with the Order pursuant to Rules 54(b) & 56 of the Federal Rules of Civil Procedure, signed by the Honorable Zita L. Weinshienk, Judge, and filed on August 10, 1990, it is therefore

ORDERED AS FOLLOWS:

1. Each and every claim asserted by Plaintiff in the Jacobs Proceedings are hereby dismissed as to each and every defendant other than the Jacobs defendants.

2. Each and every claim asserted by Plaintiff in the Action Traders Proceeding are hereby dismissed as to each and every defendant.

DATED at Denver, Colorado, August 16, 1990

FOR THE COURT:

JAMES R. MANSPEAKER

/s/ Stephen P. Ehrlich
STEPHEN P. EHRLICH, Chief Deputy

APPENDIX J

APPENDIX J

KAISER STEEL CORPORATION,
Plaintiff-Appellant,

v.

CHARLES SCHWAB & CO., INC.;
Securities and Exchange Commission,
Defendants-Appellees,
and

National Financial Services Inc.; Unter-berg, Towbin, Shearson Lehman Brothers/American Express Inc.; Amsouth Bank, N.A.; Bank of New England; Bank of New England-West; Boettcher & Company, Inc.; Drexel, Burnham & Lambert, Inc.; Brown Brothers Investment Company, Brown Brothers Harriman & Co.; Burke, Christensen & Lewis Securities, Inc.; Piper, Jaffray & Hopwood, Incorporated; Sspeak, Leeds & Kellogg; The Chicago Corporation; SLK-SEG; Tweedy Brown Clearing Corporation; Dillon, Read & Co.; Edward D. Jones & Co.; Fahnestock & Co.; Edward A. Viner & Co.; First Albany Corp.; Tucker, Anthony & R.L. Day, Inc.; Thompson, McKinnon & Co., Inc.; Wells Fargo; Crocker National Bank; Kellner, Dileo & Co., Inc.; Mabon, Nugent & Co.; Ernst & Company; Evans & Co., Inc.; JW Charles Securities, Inc.; Josephthal & Co., Inc.; Herzfeld & Stern, n/k/a JII Securities, Inc.; Lewco Securities Corp.; National Bank of Detroit; May Financial Corporation; Manufacturers and Traders Trust Co.; Bankers Trust of New York; Olde Discount Corporation; Roney & Co.; Stifel Nicolous & Company; United States Trust Company of New York; Pacific & Co.; Securities Settlement Corporation; Stephens, Inc.; Chemical Bank; Morgan Guaranty Trust Company of New York; Millikin National Bank of Decatur,
Defendants,

and

Bear Stearns & Co., Inc.; Cowen & Co.; Doft & Co., Inc.; L.F. Rothschild & Co., Inc.; Smith, Barney, Harris, Upham & Co., Inc.; Herzog, Heine & Geduld, Inc.; M.H. Davidson & Co. Inc.; Cascade Fund,
Defendants-Intervenors.

No. 90-1078.

United States Court of Appeals,
Tenth Circuit.

Sept. 7, 1990.

Rehearing Denied Oct. 24, 1990.

Susan M. Freeman, Lewis and Roca, Phoenix, Ariz. (Marty Harper, Lewis and Roca, Phoenix, Ariz., G. Stephen Long, and David J. Richman, Coghill & Goodspeed, Denver, Colo., with her, on briefs), for plaintiff-appellant.

Thomas H. Young (Michael J. Guyerson, with him, on brief), Rothgerber, Appel, Powers & Johnson, Denver, Colo., for defendant-appellee, Charles Schwab & Co., Inc.

Katharine Gresham, Asst. Gen. Counsel (Paul Gonson, Sol., of counsel, James R. Doty, Gen. Counsel, Jacob H. Stillman, Associate Gen. Counsel, and Joseph H. Harrington, with her, on brief), S.E.C., Washington, D.C., for defendant-appellee, Securities and Exchange Com'n.

David I. Blejwas, Hahn & Hessen, New York City, for defendants-intervenors.

Before HOLLOWAY, Chief Judge, and ANDERSON and TACHA, Circuit Judges.

STEPHEN H. ANDERSON, Circuit Judge.

Debtor-in-possession Kaiser Steel Resources, Inc. ("Kaiser"), formerly known as Kaiser Steel Corporation ("Kaiser Steel"), appeals from the district court's reversal of the bankruptcy court's order denying defendant Charles Schwab & Company, Inc. ("Schwab") summary judgment. We affirm.

In late 1983, the board of directors of Kaiser Steel, a publicly-traded corporation, agreed to a leveraged buyout ("LBO") by a group of outside investors ("the acquisition group"). Under the plan, a new entity owned by the acquisition group would purchase all outstanding Kaiser Steel common stock and merge with Kaiser Steel. Each share of Kaiser Steel common stock would be converted into the right to receive twenty-two dollars and two shares of preferred stock[1] in the surviving entity. The money, which amounted to $162 million, was to come from Kaiser Steel's cash reserves and a $100 million loan from Citibank secured by the corporation's assets. R.Vol. I, Tab 10 at 3-4, Ex. 17 at 27-37.

The shareholders approved the LBO on January 18, 1984. As of the effective date of the merger, February 29, 1984, holders of Kaiser Steel common stock were required to tender their shares

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[1] The surviving entity's common stock would be owned entirely by the acquisition group.

to Kaiser's disbursing agent, Bank of America, which distributed the cash and preferred stock. R.Vol. I, Tab 10 at 4. The New York Stock Exchange delisted the stock the following day. R.Vol. II, Tab 46, Ex. 1 at 1.

Among the holders of Kaiser Steel common stock were customers of Schwab, a securities broker. Most of the certificates were in the possession of the Depository Trust Company ("DTC"), a securities clearinghouse. DTC tendered the shares to Bank of America, and received the cash and preferred stock in the surviving entity. DTC transferred the money to Schwab through the National Securities Clearing Corporation, which sponsors Schwab's participation in DTC. R.Vol. I, Tab 9 at 1, 4-6. Some of the transfers were made directly between Schwab and Bank of America because DTC stopped handling Kaiser stock. *Id.* at 6-7; R.Vol. II, Tab 12, Ex. A at 2. Schwab credited its customers' accounts within a few days of receiving the funds. R.Vol. II, Tab 12, Ex. B at 2-3. All told, Schwab handled approximately $450,000. R.Vol. I, Tab 9 at 8.

In 1987, Kaiser filed for bankruptcy. The debtor-in-possession commenced this fraudulent conveyance action against a number of defendants, seeking to avoid the LBO and recover the $162 million. Schwab moved for summary judgment on two grounds: that it was not liable because it was a "mere conduit" rather than a transferee, *see* 11 U.S.C. § 550(a), and that the LBO payments were exempt from avoidance as settlement payments, *see* 11 U.S.C. § 546(e).[2] The bankruptcy court denied the motion. *In re*

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[2] Actually, Schwab's motion only raised the conduit question. The settlement payment issue was raised by other defendants which were allowed to intervene. We permitted these defendants to intervene before this court as well.

Kaiser Steel Corp. (Kaiser Steel Corp. v. Jacobs), 105 B.R. 639 (Bankr.D.Colo.1989). The district court accepted an interlocutory appeal and reversed the bankruptcy court on both issues. *In re Kaiser Steel Corp. (Kaiser Steel Resources, Inc. v. Jacobs)*, 110 B.R. 514 (D.Colo.1990). The district court then entered a final judgment in the matter pursuant to Rule 54(b) of the Federal Rules of Civil Procedure. Because we affirm on the settlement issue, we do not reach the conduit question.

> A trustee or debtor-in-possession may not avoid
>
> a transfer that is a margin payment, as defined in section 741(5) or 761(15) of this title, or a settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)[3] of this title."

11 U.S.C. § 546(e). Section 741(8) defines settlement payment as "a preliminary settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8). We agree with the district court that the transfer of the consideration in the LBO was a settlement payment.

The definition in section 741(8), while somewhat circular, is "extremely broad," *In re Bevill, Bresler & Schulman Asset Manage-*

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[3] 11 U.S.C. § 548(a)(1) applies to transfers made within a year of the bankruptcy filing with actual intent to hinder, delay, or defraud a creditor.

ment Corp. (Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Savings & Loan Ass'n), 878 F.2d 742, 751 (3d Cir.1989), in that it clearly includes anything which may be considered a settlement payment. *See In re Blanton (Blanton v. Prudential-Bache Securities, Inc.)*, 105 B.R. 321, 347 (Bankr.E.D.Va. 1989) (because margin and settlement payment are "very broadly defined by the Bankruptcy Code," court accepts the argument that "any payment by [the debtor] which was used to reduce a deficiency in his margin account constituted either a margin or settlement payment for purposes of the exception under § 546(e)"); *see also In re Bevill, Bresler & Schulman Asset Management Corp. (Cohen v. Savings Building & Loan Co.)*, 896 F.2d 54, 61 (3d Cir.1990) (holding that transferring securities to a safekeeping account for a purchaser is a settlement payment; apparently overruling *In re Bevill, Bresler & Schulman, Inc. (Hill v. Spencer Savings & Loan Ass'n)*, 94 B.R. 817, 828-29 (D.N.J. 1989)). *But cf. In re Edelsberg (Edelsberg v. Thompson McKinnon Securities, Inc.)*, 101 B.R. 386, 389 (Bankr.S.D.Fla.1989) (execution of judgment on debt for settlement payment is not itself a settlement payment).

Such an interpretation "is consistent with the legislative intent behind § 546 to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions." *Kaiser Steel Resources, Inc. v. Jacobs*, 110 B.R. at 522.

Section 546 was first enacted in 1978, and applied only to commodities markets. *See* 11 U.S.C. § 764(c) (repealed 1982).[4] "Settlement payment" was not defined. Congress sought to "promote customer confidence in commodity markets generally" via "the protection of commodity market stability." S.Rep. No. 989, 95th Cong., 2d Sess. 8 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5794. However, because the provision only applied to margin payments to brokers and settlement payments from clearing organizations, it could be said only to "protect[] the ordinary course of business in the market." H.R.Rep. No. 595, 95th Cong., 2d Sess. 392 (1978), *reprinted in* 1978 U.S. Code Cong. & Admin.News 5963, 6348. *But see* 124 Cong.Rec. 17,433 (1978) (the section "protect[s] all margin payments in the customer-broker-clearinghouse chain") (statement of Sen. Mathias).

In 1982, "Congress was concerned about the volatile nature of the commodities and securities markets . . .," *Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Savings & Loan Ass'n*, 878 F.2d at 747, so former section 764(c) was replaced by sections 546(e) and 741(5) and (8) "to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market." H.R.Rep. No. 420, 97th Cong., 2d Sess. 2 (1982), *reprinted in* 1982 U.S.Code Cong. & Admin. News 583, 583. The protection was expanded beyond the ordinary course of business to include margin and set-

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[4] Commodities markets were singled out because the measure was a response to the decision in *Seligson v. New York Produce Exchange*, 394 F.Supp. 125 (S.D.N.Y.1975), that a trustee could recover a margin payment made to a commodities clearinghouse. White, *The Commodity-Related Provisions of the Bankruptcy Act of 1978*, 34 Rec.Bar.A. Bar City of New York 262, 269-71 (1979); *see* Sen.R.Rep. No. 989, 95th Cong., 2d Sess. 106 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5892.

tlement payments to and from brokers, clearing organizations, and financial institutions.[5] Again, Congress's purpose was "to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Id.* at 1, *reprinted in* 1982 U.S.Code Cong. & Admin. News at 583. The danger of a "ripple effect," *id.*, on the entire market is at least as inherent in the avoidance of an LBO as it is in the avoidance of a routine stock sale.

Finally, interpreting "settlement payment" to include the transfer of consideration in an LBO is consistent with the way "settlement" is defined in the securities industry. Settlement is "the completion of a securities transaction." A. Pessin & J. Ross, *Words of Wall Street: 2000 Investment Terms Defined* 227 (1983); *accord* D. Brownstone & I. Franck, *The VNR Investor's Dictionary* 279 (1981) ("finishing up of a transaction or group of transactions"); Group of Thirty, *Clearance and Settlement Systems in the World's Securities Markets* 86 (1989) ("[t]he completion of a transaction, wherein securities and corresponding funds are delivered and credited to the appropriate accounts"); New York Stock Exchange, *Language of Investing Glossary* 30 (1981) ("[c]onclusion of a securities transaction when a customer pays a broker/dealer for securities purchased or delivers securities sold and receives from the broker the proceeds of a sale"); D. Scott, *Wall Street Words* 320 (1988) ("[t]ransfer of the security (for the seller) or

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[5] One commentator takes the position that the 1982 amendment did not expand the provision. *See* 4 L. King, *Collier on Bankruptcy* ¶ 546.05, at 546-24 (15th ed. 1990). We reject this position, for it ignores significant changes in the statutory language. "Where the words of a later statute differ from those of a previous one on the same or related subject, the Congress must have intended them to have a different meaning." *Muscogee (Creek) Nation v. Hodel*, 851 F.2d 1439, 1444 (D.C.Cir.1988), *cert. denied*, 488 U.S. 1010, 109 S.Ct. 795, 102 L.Ed.2d 786 (1989).

cash (for the buyer) in order to complete a security transaction").[6] The Securities and Exchange Commission has taken the position before this court that the consummation of an LBO is a "settlement payment" exempted from avoidance by section 546(e).[7]

Kaiser's position that section 546(e) was only intended to insulate from avoidance routine securities transactions is not without merit. Neither LBOs nor other exceptional transactions were even mentioned in any of the discussions of the securities industry in the reports, debates, and hearings on the bill. *See Bankruptcy of Commodity and Securities Brokers: Hearings Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 97th Cong., 1st Sess. 238-349 (1981). However, because of the variety and scope of different securities transactions, and the absence of any restrictions in sections 546(e) and 741(8), it would be an act of judicial legislation to establish such a limitation.

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[6] Some sources limit the concept of "settlement" to the consummation of routine securities transactions. *See, e.g.,* C. Ammer, *The A to Z of Investing* 243 (1986); M. Thomsett, *Webster's New World Investment and Securities Dictionary* 261 (1986). Kaiser's expert witness held this view. *See* R.Vol. II, Tab 46, Ex. 2 at 2-3. So narrow a definition has already been rejected. See *Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Savings & Loan Ass'n*, 878 F.2d at 751-52 (declining to "accept the district court's interpretation of 'settlement payment' as a transaction that is completed within five days of the original agreement").

[7] The SEC filed a brief in this case and participated in oral argument. As a statutory party in corporate reorganization proceedings, the Commission acts as a special advisor to the courts. *See* 11 U.S.C. § 1109(a). Although precluded from initiating an appeal when appearing in this capacity, the Commission may participate in an appeal taken by others. *Sheftelman v. Standard Metals Corp.*, 839 F.2d 1383, 1386 (10th Cir.1987), *cert. dismissed*, 488 U.S. 881, 109 S.Ct. 201, 102 L.Ed.2d 171 (1988).

What occurred in this case was "the delivery and receipt of funds and securities." *National Securities Clearing Corp.*, 42 Fed.Reg. 3916, 3920 n. 56 (1977). The LBO was a securities transaction.[8] The transfer of money and preferred stock was the settlement of that transaction. Therefore, the transfers to Schwab were exempt from avoidance under section 546(e) as "settlement payment[s] . . . to a . . . stockbroker."

The judgment of the district court is AFFIRMED.

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[8] Because Kaiser Steel common stock was converted from incidents of corporate ownership into the right to receive cash and preferred stock in the surviving entity, and could no longer be traded on the New York Stock Exchange, Kaiser contends that the shares were no longer securities, so the LBO was not a securities transaction.

We disagree. The shares were securities when the parties agreed to the LBO. A technical change in how Kaiser regarded them after the merger should not obscure the more sensible interpretation of the transaction: that the owners of Kaiser Steel sold their common stock for cash and preferred stock. That LBOs of publicly-traded companies are securities transactions is shown by the fact that they are within the purview of the Securities and Exchange Commission. *See* 17 C.F.R. 240.13e-3; *see also Regulatory Flexibility Agenda and Rules Scheduled for Review*, 54 Fed.Reg. 45,646 (1989).

APPENDIX K

APPENDIX K

11 U.S.C. § 362

§ 362. Automatic stay.

* * *

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 USC 78eee(a)(3)), does not operate as a stay —

* * *

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 101(34)[sic(38)], 741(5) or 761(15) of this title, or settlement payment, as defined in section 101(35)[sic(39)] or 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from such commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts.

11 U.S.C. § 546

§ 546. Limitations on avoiding powers.

* * *

(e) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101(34), [sic(38)] 741(5) or 761(15) of this title, or settlement payment, as defined in section 101(35) [sic(39)] or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

11 U.S.C. § 550

§ 550. Liability of transferee of avoided transfer.

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. § 741

§ 741. Definitions for this subchapter.

* * *

(7) "securities contract" means contract for the purchase, sale, or loan of a security, including an option for the purchase or sale of a security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any option entered into on a national securities exchange relating to foreign currencies, or the guarantee of any settlement of cash or securities by or to a securities clearing agency;

(8) "settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.

APPENDIX L

APPENDIX L

LIST OF RESPONDENTS

From Case No. 90-1243, 10th Circuit:

1. Pearl Brewing Company
2. Falstaff Brewing Company
3. Oppenheimer & Co. Inc.
4. Josephthal & Co., Josephthal & Co. Incorporated
5. The Hillman Co., individually and as trustee for the N.M.U. Pension Trust
6. Herzfeld & Stern Inc., now known as JII Securities, Inc.
7. Goldman Sachs & Co.
8. A.G. Becker Paribes Inc., now known as Merrill Lynch Money Market, Inc.
9. A.G. Edwards & Sons, Inc.
10. Alpine Associates
11. Asiel & Co.
12. Bankers Trust Company
13. Barclay's Bank International Limited
14. Bear Stearns & Co., individually and as Custodian for the IRA account of Robert W. Sabes
15. Bradford Trust Co.
16. Cowen & Co.
17. Crocker National Bank
18. Dain Bosworth, Inc.
19. Dillon Read & Co., Inc., individually and as General Partner of B/DR Arbitrage Fund Limited Partnership
20. Doft & Co., Inc.
21. Drexel Burnham Lambert, Inc.
22. Easton & Co.

23. Engler & Budd Company
24. Eppler, Guerin & Turner, Inc.
25. Ernst & Company
26. Evans & Co., Inc.
27. Fahnestock & Co.
28. Fifth Third Bank
29. First Kentucky Trust Company
30. Herzog, Heine, Geduld, Inc.
31. Huntington National Bank
32. Kellner, Dileo & Co.
33. Kidder, Peabody & Co.
34. L.F. Rothschild Unterberg, Towbin, now known as L.F. Rothschild & Co., Inc.
35. Lafer Amstar & Co., now known as Amstar & Co.
36. Laidlaw Adams & Peck, Inc.
37. Manufacturers National Bank of Detroit, individually and as trustee for Manufacturers Extended Index Fund
38. Marcus Schloss & Co., Inc.
39. Marine Midland Bank, N.A.
40. Moore & Schley, Cameron & Co.
41. Morgan Guaranty Trust Company
42. Morgan, Olmstead, Kennedy & Gardner, Inc., now known as Wedbush Morgan Securities
43. Newhard, Cook & Co., Incorporated
44. Oscar Gruss & Son, Inc.
45. Paine, Webber, Jackson & Curtis, Inc., now known as Paine Webber, Incorporated
46. Q & R Clearing Corporation
47. R.L. Tucker, Anthony & Day, Inc., also known as Anthony Tucker & R.L. Day, Inc.
48. Regional Clearing Corp.
49. S.B. Lewis & Co.
50. Sanford C. Bernstein & Co., Inc.
51. Securities Settlement Corp.

52. Shawmut Bank of Boston, N.A.
53. SLK-SEG
54. Smith, Barney, Harris, Upham & Co., Inc.
55. SSB-Custodian, also known as State Street Bank and Trust Co.
56. Sutro & Co., Inc.
57. Swiss American Securities, Inc.
58. Swiss Bank Corporation
59. Thomson McKinnon Securities, Inc.
60. United States Trust Company of New York
61. Walwyn Stodgell Cochran Murray, Limited
62. Weedbush, Noble & Cooke, Inc., now known as Wedbush Morgan Securities
63. Wells Fargo Bank, N.A.
64. First Arbitrage Partnership, now known as Brenzel Birkenshaw Capital, Inc.,
65. American National Bank and Trust Company of Chicago
66. K.J. Brown & Co., Inc.
67. Millikin National Bank of Decatur
68. O'Connor Securities
69. Stephens, Inc., now known as Stephens Group, Inc.
70. Larkin & Co.
71. SAIC/SNY
72. Somers Grove
73. The First Boston Corporation

From Case No. 90-1245, 10th Circuit:

1. Action Traders, Inc., now known as ATI Corporation
2. John A. Alden, M.D., & Ann Alden
3. Altona Holdings, Ltd.
4. American Fletcher Bank Suisse, now known as Merrill Lynch International Bank (Suisse), S.A.

5. Herbert M. Ames
6. Lillian Ames
7. Robert Stabler, individually and as trustee for the Amesbury Fund
8. W.H. & S.C. Amesbury, individually and as trustees for U/W/O Jane Winton & F/B/O Scott Winton
9. William H. Amesbury
10. Arshot Investment Corporation
11. Bank Oppenheim Pierson
12. IRA Account of Robert W. Sabes, and Robert W. Sabes, individually
13. Lyle A. Berman
14. Janis R. Berman
15. John C. Bondurant
16. Doris Bondurant
17. Building Service Employees Retirement Pension Fund Local 32E, AFL-CIO TN UA 06/15/55 and its trustee
18. Broadway Realty Co.
19. Bullet Bay International Co. N.V.
20. Barbara Barrett Busby, individually and as trustee FBO Barbara B. Busby Revocable Trust UTD DTD
21. Cascade Fund, a limited partnership
22. Wilfred Clegg
23. Vera Clegg, individually and as co-trustees for the Clegg Family Trust UDT DTD 5/14/71
24. College Retirement Equities Fund
25. Thomas Conway
26. Judith Ann Cotton
27. Sumner Cotton
28. Curtis Associates, Inc., individually and as trustee for the Pension Trust and the Retirement Trust
29. Alan Curtis, individually and as trustee for the Pension Trust and the Retirement Trust

30. Alan Curtis, individually and as trustee for the Alan Trust and the Curtis Trust
31. Daper Realty Inc.
32. Decisions, Inc.
33. Delbrueck & Co.
34. B/DR Arbitrage Fund Limited Partnership and Bessemer Securities Corporation as its limited partner
35. Elisabeth H. Doft
36. Alan Doft
37. E.F. Brady Company
38. Easton & Co.
39. A.G. Ellis
40. Jacquelyn Esco
41. Wells Fargo Bank, individually and as trustee of Exxon Corp. Annuity Trust Fund
42. Mary Fullerton Farr
43. Femirol Overseas S.A.
44. William Barry Furlong
45. Isabel Furlong
46. G S C of Nevada, Inc.
47. Charles R. Gesme
48. Henry Goode
49. Goode-Adel Partnership
50. Sam V. Gordon
51. Anita V. Gordon
52. Sam V. Gordon, doing business as Gordon Enterprises
53. Sheldon I. Greenberg
54. Gorden Grender
55. Bankers Trust, also known as GTE High Yield Account, individually and as trustee for GTE Service Corp.
56. Hambros Bank, Ltd.
57. Jacob Harris, M.C., P.C. Defined Benefit Pension Trust and its trustee
58. Warren Harrison

59. Doris Grunwald
60. Karin Heine
61. Peggy Heine, co-executrixes of the estate of Max L. Heine and Estate of Charlotte Heine
62. Herman Wilson Lumber Company
63. Joseph Iny
64. Mrs. Joseph Iny
65. Richard O. Jacobson
66. Sarah T. Jacobson
67. Paul Jacobson
68. Deborah F. Cooper
69. Lillian Gibson
70. Paul Schryver, as successor trustees to Eve B. Jarvis as trustee UA 07/01/64 Airlie Trust
71. Paul G. Jende
72. Arlene M. Jende
73. Clara Kellner
74. George A. Kellner
75. John Doe Trustee, individually and as trustee for the Keystone Aggressive Stock Trust, individually and as trustee for the Keystone Custodian Fund S-4
76. Kinsdale Partners
77. Sidney Kisin
78. Edmund Klein
79. Norma Klein
80. Ezra Kotcher
81. Dorothy Kotcher
82. W. Donald Larson
83. Francis W. Lawrence, individually and as trustee for U/A D.T.D. 12/30/81, Derald H. Ruttenberg Charitable Lead Annuity Trust
84. Les Fils Dreyfus & CIE S.A.
85. Hugh T. Lindsay
86. Mrs. Hugh T. Lindsay

87. James K. Lindsay
88. Mrs. James K. Lindsay
89. M. H. Davidson & Co.
90. Maerki Baumann & Co., A.G.
91. Leo Mainemer
92. Ester Mainemer
93. Elliot Marple
94. Barbara K. Marple
95. Wilbert K. Martin
96. Elizabeth M. Martin
97. Ivor Massey, Jr.
98. Jane Doe Massey
99. John B. McDonald
100. Elaine McKelvey
101. Robert D. McLean
102. Mrs. Robert D. McLean
103. Mercury Securities, Inc.
104. Midland Bank Princess Street, Nominees Limited
105. Moseley, Haugarten, Estabrook & Weeden, Inc., also known as Mosely Securities
106. Mount Sinai Medical Center, Inc.
107. Moussard S.A.
108. Michael Muller
109. Elke M. Muller
110. Nerval & Manor
111. Number Seven Account, and its trustee (029-24-9996)
112. T 98 ARB 1980, Account #000-01198 with Oscar Gruss & Sons, Inc.
113. John D. Picchetti
114. Margaret M. Picchetti
115. Picchetti, Inc.
116. Al I. Pollack
117. Beverly Pollack
118. R.P. Richards, Inc.

119. Research Charitable Trust, and its trustee
120. R. J. Scheuer & Co.
121. E. Franklin Robbins & Jane Doe Robbins
122. Robert Fleming, Inc., now known as Flemings North America Inc.
123. Royal Bank Of Scotland PLC, as trustee for RBOS-TTUTS ALL SUN AMER SPEC
124. Royal Bank of Scotland PLC, as trustee for RBOS-TT-UTS ALL DUN INTL Fund
125. Royal Bank of Scotland PLC, as trustee for RBOS-TT-UTS ALL DUN SEC AMR TR
126. Royal Investment Company
127. S. Paul Posner & Co.
128. Saltzman Partners
129. San Francisco Museum of Modern Art
130. Gene L. Schumacher
131. Mrs. Gene L. Schumacher
132. Sequoia Ins. Corp.
133. Marjorie Shamgochian and the estate of Heront Shamgochian
134. J.R. Simplot
135. Esther Simplot
136. Soberano Oceanico
137. Mary Amesbury Stabler
138. Robert C. Stabler, individually and as trustee U/A/D F/B/O L. Stabler
139. John Stavick
140. STE Jeanes Corporation
141. Jackson T. Stephens
142. Mary Anne Stephens
143. Robert S. Strauss, individually and as trustee of the Robert S. Strauss, P.C. Defined Benefit Plan
144. TR 30, a New York Partnership

145. Ultramar Travel Bureau Profit Sharing Trust, UA 11-10-67 and its trustee
146. Unicorp Canada Corporation
147. Universal Life Church, Inc. Charter, 30488 and Bayard Ryder
148. Warm Springs Associates
149. Warner W. Henry, individually and as trustee FBO Henry Family Trust UDT DTD 12/04/82
150. Waruda Holdings, Ltd.
151. Abraham Weiss
152. Ruth Weiss
153. Wells Fargo Bank, individually and as trustee of the Extended Market Fund for EBT, 368-500069 and its Participants
154. Wells Fargo Bank, individually and as trustee for Walter LeBand Trust (or Francine LeBand, individually and as executor for the Estate of Walter LeBand)
155. Jeffrey Wendel
156. Wertheim Schroder & Co., Inc.
157. Wheel Barrow & Co.
158. Harry Wilf
159. Joseph Wilf
160. Y Partnership
161. Z.H. Associates
162. Estate of Gerald L. Conrad, doing business as Conrad Sales Co.
163. McCosker Partners
164. The First Boston Corporation

(2)

No. 91-1607

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

KAISER STEEL RESOURCES, INC.,
Formerly Known as KAISER STEEL CORPORATION,
Petitioner,

—*v.*—

PEARL BREWING COMPANY, *et al.*, and
SECURITIES AND EXCHANGE COMMISSION,
Respondents.

KAISER STEEL RESOURCES, INC.
Formerly Known as KAISER STEEL CORPORATION,
Petitioner,

—*v.*—

ACTION TRADERS, INC., *et al.*, and
SECURITIES AND EXCHANGE COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
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BRIEF IN OPPOSITION

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Attorney for Respondent
Bankers Trust Company

April 30, 1992

QUESTION PRESENTED

Section 546(e) of the Bankruptcy Code provides that a trustee or debtor in possession may not exercise certain of its avoidance powers to recover a "settlement payment" made "by or to" a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency. Section 741(8) defines "settlement payment" to mean a preliminary, partial, interim or final settlement payment, a settlement payment on account, or "any other similar payment commonly used in the securities trade." The only question presented by the petition is whether, on the specific facts of this case, the payments made by Kaiser Steel Corporation in return for its outstanding common shares in 1984 constituted "settlement payments." The Court of Appeals, in the first appellate decision ever to address the application of section 546(e) to a transaction in which a public corporation purchased its stock from its shareholders, accepted the position asserted by defendants and the Securities and Exchange Commission and answered the question "yes."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-1607

KAISER STEEL RESOURCES, INC.,
Formerly Known as KAISER STEEL CORPORATION,
Petitioner,

—*v.*—

PEARL BREWING COMPANY, et al., and
SECURITIES AND EXCHANGE COMMISSION,
Respondents.

KAISER STEEL RESOURCES, INC.,
Formerly Known as KAISER STEEL CORPORATION,
Petitioner,

—*v.*—

ACTION TRADERS, INC., et al., and
SECURITIES AND EXCHANGE COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF IN OPPOSITION

Petitioner asks this Court to review the first appellate decision ever to apply section 546(e) of the Bankruptcy Code to a corporation's purchase of its shares. A similar issue has only been addressed in one reported opinion outside these proceedings, a District Court decision that is consistent in result with the decision of the Tenth Circuit. The Court of Appeals' application of section 546(e) was compelled by the plain language of the statute,

advanced the policies underlying its enactment, and was supported by the federal agency with primary responsibility and expertise with respect to those policies. Nothing about the Court of Appeals' decision merits this Court's review and the petition should be denied.

STATEMENT OF THE CASE

These consolidated appeals arise out of a leveraged buyout in 1984 (the "LBO") pursuant to which petitioner Kaiser Steel Resources, Inc. (formerly known as Kaiser Steel Corporation) ("Kaiser") made payments to the beneficial owners of its outstanding common shares in exchange for such shares. The Tenth Circuit's opinion presents the central facts pertinent to the transaction and the procedural history of the litigation (*see* Petition App. A). Accordingly, respondents here provide only a summary discussion of the nature of Kaiser's claims and the prior proceedings.

1. Kaiser's Claims

Kaiser commenced the first of these actions in 1987, shortly after filing a voluntary reorganization petition under chapter 11 of the Bankruptcy Code (the "Code"). Pursuant to section 550 of the Code, which authorizes a trustee or debtor in possession to recover voidable transfers of property from certain "transferees," Kaiser seeks to recover the payments that it made in exchange for its outstanding common stock on the ground that those payments are allegedly voidable under section 544(b) of the Code. Section 544(b) authorizes a trustee or debtor in possession to avoid transfers that could be avoided by a creditor under state law. In particular, Kaiser asserts that the payments it made are voidable under the provisions of the Uniform Fraudulent Conveyance Act ("UFCA") as adopted in California, where Kaiser was headquartered at the time of the LBO.[1]

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[1] The Bankruptcy Code includes its own fraudulent conveyance provision, section 548. This section is inapplicable to Kaiser's claims because it only authorizes the avoidance of transfers made within one year prior to the filing

(continued...)

The avoidance powers conferred by section 544 are not absolute. Section 546(e) prohibits a trustee or debtor in possession from invoking section 544 and most of the Code's other avoidance provisions to avoid a "settlement payment . . . made by or to . . . a stockbroker, financial institution, or securities clearing agency." "Settlement payment" is defined as, *inter alia*, a preliminary, partial, interim or final settlement payment "or any similar payment used in the securities trade." 11 U.S.C. § 741(8).

2. Procedural Background

The assertion that section 546(e) bars Kaiser from recovering the payments it made pursuant to the LBO was first raised in connection with a "test motion" for summary judgment by Charles Schwab & Co. ("Schwab"). Schwab received payments pursuant to the LBO solely as a financial intermediary, on behalf of its customers who owned Kaiser stock, and credited those payments to the customers' accounts.[2] The United States District Court for the

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1(...continued)

of the petition. Since Kaiser filed its petition nearly three years after the 1984 LBO, it was forced to resort to section 544 of the Code and the California UFCA.

2 In connection with Schwab's motion, Kaiser filed a Statement of Facts which described the procedure by which Kaiser's shares were exchanged for cash pursuant to the LBO as follows:

"13. In connection with exchange offers, [the Depository Trust Company] surrenders securities on behalf of, and at the instructions of, its participants and disburses payments in return for the surrendered securities, whether in cash and/or DTC-eligible securities, to its participants. . . .

"14. National Securities Clearing Corporation ("NSCC") is a participant in DTC. NSCC is also a clearing agency registered under the Securities Exchange Act of 1934. NSCC has a number of members, who may be NSCC-sponsored participants in DTC. When the Kaiser leveraged buyout took place and when dividends were thereafter paid on Kaiser preferred stock, Schwab was a member of NSCC and NSCC-sponsored participant number 0164 in DTC. DTC

(continued...)

District of Colorado, in reversing the decision of the Bankruptcy Court (Petition App. B), dismissed Kaiser's claims against Schwab on the alternate grounds that (i) Schwab was not a "transferee" from which the payments could be recovered under section 550 of the Code and (ii) the payments were exempt from avoidance under section 546(e) (Petition App. F).

Kaiser appealed that decision to the Tenth Circuit. After considering a number of briefs and oral argument, including the brief and argument submitted by the Securities and Exchange Commission in support of Schwab's position,[3] a unanimous panel of the Court of Appeals affirmed the District Court's decision solely on the grounds that the payments pursuant to the LBO were "settlement payments" and the payments received by Schwab (a stockbroker) were thus exempt from avoidance under section 546(e). *See Kaiser Steel Corp.* v. *Charles Schwab & Co.*, 913 F.2d 846, 850 (10th Cir. 1990) (Petition App. J at 10J). Kaiser did not seek certiorari to review the *Schwab* decision.

2(...continued)

credited all Kaiser funds payable to Schwab to NSCC-sponsored account 0164, and gave NSCC *a daily cash settlement statement* identifying that account and others entitled to Kaiser funds, and the amount due to each. NSCC added the credit of Kaiser funds to credits for all its other Schwab transactions on each payment date, and offset the credits against debits for all its other Schwab transactions on each date. If a net balance was due to Schwab, NSCC paid Schwab that day. If a net balance was due from Schwab to NSCC, Schwab was obligated to pay NSCC that day." Kaiser's Statement of Facts re: Schwab's Motion for Summary Judgment 5 (November 29, 1988) (emphasis added).

3 As a statutory party in corporate reorganization proceedings, the Securities and Exchange Commission acts as a special advisor to the courts in order to protect the interests of public investors. The Commission initially submitted a brief in this capacity to the District Court in support of Schwab's position. Although precluded from initiating an appeal when appearing in this capacity, the Commission may participate in an appeal taken by others. *Sheftelman* v. *Standard Metals Corp.*, 839 F.2d 1383, 1386 (10th Cir. 1987); *see* 11 U.S.C. § 1109(a).

During the pendency of Kaiser's appeal in *Schwab*, summary judgment motions were filed in the District Court by 88 other defendants that, like Schwab, received LBO payments as financial intermediaries. During oral argument on those motions, Kaiser's attorney explicitly conceded that if section 546(e) exempts the payments received by financial intermediaries from avoidance, it also exempts the payments received by the beneficial owners of the shares.[4]

The District Court granted the financial intermediaries' motions solely on the basis of section 546(e) (Petition App. G), declining to hear oral argument concerning the defendants' "transferee" status in light of alleged disputed issues of fact. In view of Kaiser's concession that this decision would require dismissal of its claims

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4 The concession (which Kaiser chose not to include in appendix G to the petition with another excerpt from the same hearing transcript) follows:

"MR. HARPER: The critical language in Section 546(e) is 'a payment by or to,' in this case, 'a stockbroker.'

". . . .

"If by chance this court rules today that these payments were payments to a stockbroker, therefore barring a suit by Kaiser against the stockbrokers, those very same payments are payments by a stockbroker to the beneficial interest—or holders; and in fact, your Honor, you are deciding that question today. That question is being presented by you, and in essence it was presented to the Tenth Circuit yesterday.

". . . .

". . . [W]e have thought long and hard about how you could differentiate or how a court could differentiate between the payment to the stockbroker and the payment by a stockbroker.

"Mr. Blejwas, has, in fact, correctly articulated and explained the distribution system; and if these are settlement payments, we submit that they would, in fact, preclude us from going against the shareholders." July 24, 1990 Tr. (R. 109) 34-35.

Kaiser made substantially similar statements in its argument before the Tenth Circuit on the *Schwab* appeal.

against the former stockholders, the District Court also stated that it was inclined to dismiss those claims *sua sponte*. The court afforded the parties an opportunity to submit briefs in support of and in opposition to its proposed decision and, after the briefs were submitted, entered an order dismissing Kaiser's claims against all its former stockholders other than the "Jacobs Group," a group that attempted to gain control of Kaiser prior to the LBO and allegedly received "greenmail" payments (Petition Apps. H, I).

Kaiser again appealed to the Tenth Circuit. After the Tenth Circuit issued its decision in *Schwab*, Kaiser stipulated to affirmance of the dismissal of all claims to recover payments that it acknowledged to have been received by the appellees as financial intermediaries.[5] The only issue before the Tenth Circuit was the application of section 546(e) to the payments received by the former beneficial owners of Kaiser stock (the respondents here).[6] The Securities and Exchange Commission again submitted a brief as a statutory party in support of the District Court's decision.

On December 30, 1991, the Tenth Circuit unanimously affirmed the dismissal of Kaiser's claims against its former stockholders (Petition App. A). Citing the Code's expansive definition of "settlement payment," the meaning of "settlement" in the securities industry and its own prior holding in *Schwab*, the Tenth Circuit again held that the LBO payments were "settlement payments." The court went on to hold that the settlement payments were exempt from avoidance in accordance with the plain language of section 546(e), noting that Kaiser did not dispute that all of the

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5 Kaiser continues to pursue its claims against certain respondents that received payments as financial intermediaries on the ground that they have not proved that they acted as financial intermediaries to Kaiser's satisfaction. As a result, Kaiser's statement that "the remaining defendants/appellees are all beneficial shareholders, in whole or in part" (Petition 8) is not entirely correct.

6 The respondents are not a homogeneous group, but rather include a wide assortment of banking institutions, stockbrokers trading for their own accounts, pension plan trustees and individual investors (including retirees).

payments to the stockholders were made *by* either a stockbroker, financial institution or securities clearing agency.

SUMMARY OF ARGUMENT

Petitioner fails even to acknowledge that certiorari is appropriate only upon a showing of "special and important reasons" for review by this Court. *See* Sup. Ct. R. 10.1. No issue presented here could justify review of the Tenth Circuit's decision.

First, the decision below does not conflict with the decision of any United States Court of Appeals. Indeed, the Tenth Circuit is the first and only Court of Appeals to have addressed the application of section 546(e) to a transaction in which a public corporation purchases its stock from its shareholders. Moreover, the Tenth Circuit's interpretation of "settlement payment" is entirely consistent with the broad construction of the term espoused by the only other Court of Appeals that has addressed it.

Second, the question decided by the Tenth Circuit is not one of such grave national importance as to require this Court's immediate attention. The decision below, applying a technical provision of the Bankruptcy Code, will not shape behavior or have any practical consequences beyond the outcome of this litigation. Nor will the decision, if left undisturbed, foreclose future litigation of the same issue in other courts. Any assertion that the application of section 546(e) to leveraged buyouts is the subject of significant public concern is belied by the fact that, outside these actions, only one other court (a District Court) has addressed the issue in a reported decision.

Simply put, Kaiser's petition for review is not supported by any compelling reasons of the character enumerated in Rule 10. Instead, the petition is devoted primarily to "deep pocket jurisprudence" and arguments that the decision below was erroneous. A party's disagreement with the outcome of litigation is not a sufficiently "special and important" reason for this Court to grant certiorari.

ARGUMENT

I.

THE TENTH CIRCUIT'S DECISION DOES NOT CONFLICT WITH THE DECISION OF ANY UNITED STATES COURT OF APPEALS.

Petitioner acknowledges that the Tenth Circuit is the only United States Court of Appeals that has addressed the application of section 546(e) to payments made to stockholders in a leveraged buyout in exchange for their shares, and accordingly concedes that the decision below does not conflict with the decision of any Court of Appeals (Petition 11).

The Tenth Circuit's conclusion that the LBO payments were "settlement payments" is also entirely consistent with the broad application of the term espoused by the only other Court of Appeals that has construed that term. In *Bevill, Bresler & Schulman Asset Management Corp.* v. *Spencer Savings & Loan Ass'n (In re Bevill, Bresler & Schulman Asset Management Corp.)*, 878 F.2d 742, 751 (3d Cir. 1989), the Third Circuit considered the expansive list of possible types of settlement payments included in section 741(8) and concluded that the term should be construed liberally in order to effectuate Congress's intention to "'ensure that the avoiding powers of a trustee are not construed to permit . . . settlement payments to be set aside except in cases of fraud [by the purchaser.]' 1982 House Report."[7]

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7 Petitioner suggests that the Tenth Circuit "erroneously considered the repurchase agreements at issue in *Bevill, Bresler* not to be trades," and therefore erroneously relied on the case for the proposition that settlement payments could occur in transactions not involving the trading of securities (Petition 18). In fact, the Tenth Circuit cited *Bevill, Bresler* as holding that the definition of settlement payment "applies to payments made in connection with a repurchase agreement, which is not a 'trade' entered into *on an exchange*" (Petition App. A at 22A-23A) (emphasis added). This was undoubtedly in response to Kaiser's argument that the (continued...)

Unable to identify a circuit split, petitioner cites a purported "direct conflict" between the decision below and the District Court's decision in *Wieboldt Stores, Inc.* v. *Schottenstein*, 131 Bankr. 655 (N.D. Ill. 1991) (Petition 11). As an initial matter, even an irreconcilable conflict with a District Court decision is rarely serious enough to justify review by this Court. Indeed, Rule 10 does not identify this type of conflict as a basis for review.

In any event, petitioner has ignored the procedural history of *Wieboldt*. The debtor in *Wieboldt* originally sought to recover funds paid to both insider and non-insider public shareholders in connection with a leveraged buyout. In a 1988 decision, the District Court dismissed the claims against the non-insider shareholders pursuant to the section 550(b) "good faith exception," finding them "innocent pawns" in the transaction. *Wieboldt Stores, Inc.* v. *Schottenstein*, 94 Bankr. 488, 503 (N.D. Ill. 1988). While there is no indication in the decision that the court considered the application of section 546(e), dismissal of the claims against the non-insider shareholders would have been entirely consistent with section 546(e). The defendants that unsuccessfully sought dismissal pursuant to section 546(e) in the 1991 *Wieboldt* decision cited by petitioner were all insider shareholders that played some role in engineering the transaction, and were all facing allegations of actual fraud in connection with transfers that occurred within one year prior to the filing of the petition. *See* 131 Bankr. at 663; 94 Bankr. at 493-96. Since section 546(e) does not bar a claim pursuant to section 548(a)(1) of the Code, relating to transfers made within one year before the petition with actual intent to defraud, these are precisely the types of defendants whose liability is largely unaffected by section 546(e). Any perceived conflict with *Wieboldt* is substantially diminished in light of these facts.

The fact that the Tenth Circuit is the only court other than the District Court in *Wieboldt* to consider the issue presented by the

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7(...continued)

term "settlement payment" only applies to the completion of routine securities transactions on an organized exchange.

petition militates strongly against immediate review by this Court, and in favor of allowing further consideration of the issue in the lower courts.

II.

THE QUESTION PRESENTED IS NOT SUFFICIENTLY IMPORTANT TO WARRANT THIS COURT'S REVIEW.

The question of whether a provision of the Bankruptcy Code should be applied in accordance with its terms to a leveraged buyout is not of such public importance that this Court should review the decision below in the absence of a circuit conflict. Contrary to petitioner's assertions, neither the decision's impact on Kaiser's retirees nor its possible effect on future LBO-related fraudulent conveyance actions is a "special and important reason" for certiorari.

The possible effect of the Tenth Circuit's decision on the continued availability of pension and medical benefits to Kaiser's retirees may arouse some sympathy, but it is not a matter of significant national importance. It is well-established that an issue only warrants this Court's review on the basis of importance if it is important to the public, as opposed to particular parties. *See Rice* v. *Sioux City Cemetery*, 349 U.S. 70, 79 (1955); *Layne & Bowler Corp.* v. *Western Well Works, Inc.*, 261 U.S. 387, 393 (1923). Petitioner's attempt to appeal to emotion, therefore, is wholly inappropriate and should be disregarded.[8]

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[8] Petitioner suggests that many of Kaiser's stockholders were paid handsome premiums when they tendered their shares in the LBO (Petition 3, 27). In fact, in the weeks before the LBO, investors were purchasing and selling Kaiser common stock in the open market for prices in excess of $41.00 per share. *See Daily Stock Price Record-New York Stock Exchange*, October 1983-March 1984, ed. Standard & Poor's Corp. The consideration paid for each share pursuant to the LBO comprised the $22.00 in cash Kaiser now seeks to recover plus two shares of preferred stock with a combined market value of approximately $20.00. Kaiser

(continued...)

The Court of Appeals' interpretation of section 546(e) is of no importance to the planning of any future transactions. No board of directors would ever rationally engage in a leveraged buyout that might involve a fraudulent conveyance in reliance on the protection afforded to stockholders by section 546(e). The laws of Delaware and many other jurisdictions provide that directors are personally liable if they cause their corporation to make payments to stockholders that render the corporation insolvent. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 160(a)(1), 174(a) (1991); CAL. CORP. CODE §§ 316(a)(1), 501 (West 1990); N.Y. BUS. CORP. LAW §§ 510(a), 513, 719(a) (McKinney 1986). Section 546(e) is of importance solely in resolving post-transaction litigation, not in the conduct of business.

Finally, any assertion that the question presented assumes national importance is belied by the fact that, since section 546(e)'s enactment in 1982, litigation outside these actions over the application of section 546(e) to leveraged buyouts has resulted in only one reported decision. It cannot be seriously contended that an issue arising so infrequently is particularly important or significant.

III.

THE TENTH CIRCUIT'S DECISION WAS CORRECT.

Rather than identifying "special and important reasons" for review by this Court as directed by Rule 10, Kaiser devotes most of its petition to arguments that the Tenth Circuit's decision was erroneous. Kaiser urges that two unanimous panels of the Tenth

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8(...continued)

> does not pretend that it can assert claims against persons that sold their shares in the public market prior to the LBO for $41.00 in cash. It would be highly inequitable to permit a recovery of $22.00 per share against arbitrageurs or other investors that at most reaped a modest one dollar per share profit by buying shares from the public and reselling them to Kaiser, and that may actually have incurred losses if the preferred shares were not sold prior to Kaiser's bankruptcy for their original market value.

Circuit and the Securities and Exchange Commission were incorrect in characterizing the LBO payments as "settlement payments."[9]

A. The Tenth Circuit Correctly Held that the LBO Payments Were "Settlement Payments."

The Tenth Circuit, both in *Schwab* and the instant actions, held that the LBO payments were "settlement payments" as defined by section 741(8) of the Code.[10] That holding is supported by the expansive language of section 741(8) and by the holdings of the only other courts that have addressed the definition of "settlement payment." *See Bevill, Bresler & Schulman Asset Management Corp.* v. *Spencer Savings & Loan Ass'n (In re Bevill, Bresler & Schulman Asset Management Corp.)*, 878 F.2d 742, 751 (3d Cir. 1989); *Jonas* v. *Farmer Bros. Co. (In re Comark)*, 124 Bankr. 806, 816-17 (Bankr. C.D. Cal. 1991); *Blanton* v. *Prudential-Bache Securities, Inc. (In re Blanton)*, 105 Bankr. 321, 347-48 (Bankr. E.D. Va. 1989). Those courts recognized that the term must be

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9 Kaiser also argued in the Court of Appeals that section 546(e) should be read only to exempt payments made "to" the entities enumerated in the statute, and not payments made "by" those entities to stockholders. This argument, which Kaiser is apparently no longer pursuing, is flatly contradicted by the plain language of section 546(e) which clearly exempts from avoidance any settlement payments made "by *or* to" the enumerated entities.

10 In *Schwab*, the Tenth Circuit held that all of the LBO payments were "settlement payments" (Petition App. J at 10J). Curiously, Kaiser did not seek this Court's review of that decision. Equally curious is Kaiser's decision to abandon its claims against the other financial intermediaries after the District Court dismissed the claims against them, holding that the LBO payments were "settlement payments" as a matter of law (Petition App. G at 7G). Whatever strategy governed these tactics, it certainly appears inconsistent for Kaiser now to challenge the Tenth Circuit's "settlement payment" holding only with respect to the former stockholders. While a determination that the LBO payments were not "settlement payments" would not affect the liability of the financial intermediaries that have been dismissed from this litigation, it would eliminate section 546(e)'s protections for financial intermediaries in future cases.

interpreted broadly to effectuate Congressional intent, which was "to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." H.R. Rep. No. 420, 97th Cong., 2d Sess. 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583.

Section 741(8) defines "settlement payment" as, *inter alia*, a preliminary, partial, interim or final settlement payment "or any similar payment used in the securities trade." The Tenth Circuit recognized that this definition must be applied in accordance with the industry meaning of "settlement payment" (Petition App. A at 17A-18A). Petitioner now maintains that the Tenth Circuit misapplied the securities industry's definition of the term, notwithstanding the fact that the Securities and Exchange Commission — the federal agency that regulates the securities industry — submitted briefs throughout these proceedings stating that the LBO payments fit within the industry definition of "settlement payments."

Petitioner's arguments (most of which were presented to the Tenth Circuit and rejected as indicated in the decision below) lack any support as authoritative on the issue as the views of the Securities and Exchange Commission, and contradict the sweeping statutory definition of "settlement payment."

B. The Tenth Circuit Correctly Held that Section 546(e) Exempts from Avoidance the Settlement Payments to the Stockholders.

Despite the clear application of section 546(e) to the payments to Kaiser's stockholders, and in blatant disregard of its concession to the District Court that section 546(e) would apply equally to the financial intermediaries and the stockholders, petitioner now contends that the Tenth Circuit erroneously applied section 546(e) to the LBO payments received by the stockholders. Petitioner's position is entirely inconsistent with firmly established rules of statutory construction and with the relevant public policies, both of which confirm that the Tenth Circuit's decision was correct.

1. The Plain Language of Section 546(e) Is Controlling.

Section 546(e) is cast in unequivocal terms: it clearly exempts from avoidance any settlement payment made "by *or* to" a stockbroker, financial institution or securities clearing agency. Thus, a trustee is precluded from recovering any settlement payment made *by* an enumerated entity, without regard to the recipient of the payment. Nothing in section 546(e) or any other provision of the Bankruptcy Code even remotely suggests that Congress intended otherwise.[11] In these circumstances, a court must apply the plain language of section 546(e). *See Union Bank* v. *Wolas*, 112 S. Ct. 527 (1991).

Since Kaiser does not dispute that all of the LBO payments to the stockholders were made *by* one of the entities enumerated in Section 546(e), it has no tenable basis for challenging the Tenth Circuit's decision. Petitioner's assertion that settlement payments received by beneficial shareholders are not exempt from recovery because Congress did not include "equity security holders" within the scope of section 546(e) (Petition 14) is spurious. By exempting payments made "by" an enumerated entity without regard to the recipient of the payments, Congress avoided the necessity of

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11 Comparison with sections 362(b)(6) and 548(d)(2) of the Bankruptcy Code confirms that section 546(e) exempts settlement payments made by the enumerated entities without regard to the identity of the recipient. Section 362(b)(6) creates an exemption to the automatic stay to permit setoffs of certain margin payments or settlement payments, and section 548(d)(2)(B) provides that certain margin and settlement payments shall be deemed to be taken for value for purposes of the Code's fraudulent conveyance provisions. In both sections 362(b)(6) and 548(d)(2), the preferential treatment is explicitly limited to payments owed to or received by one of the enumerated entities that are also referred to in section 546(e). In contrast, section 546(e) explicitly exempts such payments when made "by" as well as "to" one of the enumerated entities. The choice of starkly different language for section 546(e) reflects a deliberate choice to exempt exactly the payments that Kaiser asserts were not within Congress's intent.

including "equity security holders" and all other possible recipients in the language of section 546(e).

2. Applying Section 546(e) in Accordance With Its Plain Language Is Consistent With Compelling Federal Policies.

As the Tenth Circuit recognized in its *Schwab* decision, applying the plain language of section 546(e) to the payments received by respondents is consistent with sound public policy considerations, such as "protect[ing] the nation's financial markets from the instability caused by the reversal of settled securities transactions" (Petition App. J at 6J). Congress has always been vitally concerned with protecting investors in the securities markets, and has repeatedly enacted legislation designed to establish such protections.

For example, in 1975 Congress adopted legislation, codified as section 17A of the Securities Exchange Act of 1934, in which it called for the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions. In so doing, Congress recognized that "the securities markets of the United States are indispensable to the growth and health of this country's and the world's economy," H.R. Conf. Rep. No. 229, 94th Cong., 1st Sess. 91 (1975). Congress also found that the prompt and efficient settlement of securities transactions is of vital importance to the integrity of those securities markets. *Id.*; Securities Exchange Act § 17A, 15 U.S.C. § 78q-1.

Congress thus endeavored to promote the development and use of efficient securities markets and to protect the participants in those markets. Like the promotion of efficient securities clearance and settlement systems, the enactment of section 546(e) to protect payments made through those systems implements the policies of safeguarding public confidence in the securities markets and encouraging active participation in those markets. Indeed, the Securities and Exchange Commission urged Congress to adopt section 546(e) and related amendments to the Bankruptcy Code in order to eliminate uncertainties that are inimical to the efficient

working of the national securities clearance and settlement system, "uncertainties which could jeopardize the protection of investors which Congress endorsed so strongly in the 1975 amendments to the Exchange Act," *Bankruptcy of Commodity and Securities Brokers: Hearings Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 97th Cong., 1st Sess. 238 (1981) (Testimony of SEC Commissioner Bevis Longstreth).

In enacting section 546(e)'s restrictions on the avoidance of settlement payments, Congress weighed the policy of ensuring stability and certainty in securities transactions against the policy of allowing bankruptcy trustees and debtors in possession to undo transactions with the aid of the fraudulent conveyance laws. Congress struck a balance between these competing policies by insulating securities transactions from avoidance unless (i) the bankruptcy trustee is able to demonstrate fraudulent intent and (ii) the bankruptcy petition is filed within one year after the transaction, as required by section 548(a)(1). Thus, with the exception of transfers subject to section 548(a)(1), Congress made a conscious decision that market participants should not be held accountable for transfers made by or to them in settlement of securities transactions.

The limitations of section 546(e) ensure the finality of settled securities transactions. Unless these limitations are strictly enforced to preclude the reversal of settled securities transactions, investor confidence and the attendant stability of the securities markets will be seriously undermined. Sound considerations of public policy such as these confirm that the Tenth Circuit was correct in precluding Kaiser from recovering the LBO payments from its former stockholders.

CONCLUSION

The petition does not identify any sufficiently "special and important reasons" for this Court to issue a writ of certiorari to review the decision below. Accordingly, the petition should be denied.

Respectfully submitted,

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April 30, 1992

APPENDIX

Rule 29.1 Statement

Pursuant to Rule 29.1 of this Court, respondents joining in this Brief in Opposition that are corporations submit this designation of corporate relationships.

1. Respondent A.G. Edwards & Sons, Inc. is wholly owned by A.G. Edwards, Inc.

2. Respondent Bankers Trust Company is wholly owned by Bankers Trust New York Corporation. The following entities are publicly-held subsidiaries of Bankers Trust Company: Bankers Trust International PLC, Mortgage Asset Residential SEC No. 1 PLC, Mortgage Asset Residential SEC No. 2 PLC, Pyramid Holdings PLC and World Markets Company PLC, which are all part of Bankers Trust Company's European holdings.

3. Respondent Dillon, Read & Co. Inc. is wholly owned by Dillon, Read Inc., which is wholly owned by Dillon, Read Holding Inc. Dillon, Read Holding Inc. is 60% owned by Dillon, Read & Co. Inc.'s senior management and 40% owned by Baring (U.S.) Holdings Limited, an indirect wholly owned subsidiary of Barings plc. The following entities are subsidiaries of Dillon, Read & Co. Inc.: Again Limited (Channel Islands), Dillon, Read Capital Inc., Dillon, Read Limited, Dillon, Read Real Estate Inc., Dillon, Read Services Inc. and Selinus Corporation N.V.

4. Respondent Eppler, Guerin & Turner is wholly owned by Principal Mutual Life Insurance Company.

5. Respondent Falstaff Brewing Corp. is wholly owned by S&P Company.

6. Respondent Flemings North America Inc. has been merged into Robert Fleming Inc., which is wholly owned by Robert Fleming Holdings, Inc.

7. Respondent Marcus Schloss & Co., Inc. has no corporate parent. Marsch & Co. is a subsidiary of Marcus Schloss & Co., Inc.

8. Respondent Marine Midland Bank, N.A. is wholly owned by Hong Kong and Shanghai Banking Corporation, Limited.

9. Respondent Pearl Brewing Company is wholly owned by S&P Company.

10. Respondent Securities Settlement Corporation is wholly owned by Securities Settlement Holding Co., Inc., which is wholly owned by Jesup Josephthal Securities Group, Inc.

11. Respondent Smith Barney, Harris Upham & Co. is wholly owned by Primerica Corporation, which is wholly owned by Primerica Holdings, Inc., which is wholly owned by Smith Barney Holdings, Inc., which is wholly owned by Smith Barney Inc.

12. Respondent Sutro & Co., Inc. is wholly owned by John Hancock Mutual Life Insurance Company.

13. Respondent U.S. Clearing Corp. is wholly owned by Quick & Reilly Group, Inc.

MOTION FILED
APR 28 1992

(3)

No. 91-1607

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

KAISER STEEL RESOURCES, INC.,
formerly known as
KAISER STEEL CORPORATION,
Petitioner,
v.
PEARL BREWING COMPANY, et al., and
SECURITIES AND EXCHANGE COMMISSION,
Respondents.

KAISER STEEL RESOURCES, INC., formerly known as
KAISER STEEL CORPORATION,
Petitioner,
v.
ACTION TRADERS, INC., et al., and
SECURITIES AND EXCHANGE COMMISSION,
Respondents.

MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF IN SUPPORT OF PETITIONER KAISER STEEL RESOURCES, INC.'S PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT AND PROPOSED BRIEF

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MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF IN SUPPORT OF PETITIONER KAISER STEEL RESOURCES, INC.'S PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Credit Managers Association of California respectfully moves the Court for leave to file the accompanying brief in

this case as *amicus curiae*. The consent of the attorneys for the following parties has been obtained to the filing of a brief by Credit Managers Association of California as *amicus curiae*: Kaiser Steel Resources Inc., petitioner; and Goldman, Sachs & Co., Asiel & Co., Marcus Schloss & Co., Inc., S.B. Lewis & Co., Marine Midland Bank, N.A., Robert Fleming, Inc., Eppler Guerin & Turner, Inc., Sutro & Co., Inc., A.G. Edwards & Sons, Inc., U.S. Clearing Corporation, Dillon, Read & Co., Inc., Curtis Associates, Inc., Allan Curtis, B/DR Arbitrage Fund, Goode-Adel Partnership, Trustee of Keystone Aggressive Stock Trust and Trustee of Keystone Custodian Fund, S-4, respondents.

Respondent Credit Managers Association did not receive any response to its inquiry seeking consent to its filing an amicus brief from the remaining parties except for Stephens Group, Inc. f/k/a Stephens Inc., Jackson T. Stephens and Mary Anne Stephens who refused to consent.

Applicant, Credit Managers of California, has an interest in this case in that it is a voluntary association of approximately 3,500 members generally representing the interests of unsecured trade creditors, particularly in the bankruptcy and insolvency area. It often serves as a disbursing agent under reorganization plans or as an officer of committees of creditors and, as such, has been and is involved in litigation concerning the setting aside of leveraged buyout transactions which raise the same issues as those raised in the present case. The brief of the petitioner in the present case argues that the rights of unsecured creditors, along with those of retirees, pensioners and the Pension Benefit Guaranty Corporation, are injured by the effect of the decision of the Court of Appeals for the Tenth Circuit. That brief does not, how-

ever, adequately address the impact of this decision on the nation's issuers of unsecured trade and supplier credit.

April 28, 1992

Respectfully submitted,

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AMICUS CURIAE BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

INTEREST OF *AMICUS CURIAE*

Credit Managers Association of California ("CMAC") is the largest voluntary association of business credit issuers in the United States, representing approximately 3,500 members throughout the State of California. CMAC was incorporated as a California Corporation in 1961, and traces its origins to the Los Angeles Board of Trade, which was formed in 1883 to handle the problems of distressed business debtors and other issues of the Los Angeles business community. Through continued growth and merger with other similar organizations, CMAC has grown so that its service area now includes the entire State of California. CMAC is affiliated with the National Association of Credit Managers and is by far the largest of any of the over 65 regional associations affiliated with that association.

CMAC's adjustment bureau assists in the rehabilitation of distressed businesses and assists its members in the settlement of debts through extension agreements, compromise agreements and general assignments for the benefit of creditors. It serves in cases under Chapter 11 of the Bankruptcy Code (11 U.S.C. § 101 et. seq.) as the secretary to official committees of unsecured creditors formed pursuant to 11 U.S.C. § 1104 and as the bankruptcy court appointed Disbursing Agent and Plan Agent pursuant to 11 U.S.C. § 1123 under confirmed plans of reorganization. As such, CMAC often pursues claims held by debtors under the Bankruptcy Code, including claims to avoid fraudulent conveyances, for the benefit of unsecured creditors. In such capacities, CMAC has been the

plaintiff in numerous adversary proceedings seeking to set aside the transfer of corporate assets to shareholders in leveraged buyout transactions as fraudulent conveyances, illegal dividends and illegal distributions of funds held in trust by insolvent corporations for the benefit of creditors. In addition, CMAC provides educational services to its members and represents business credit interests before the California legislature.

The interests of business credit issuers are profoundly effected by the decision of the court below. The Tenth Circuit's decision has injected an unwarranted degree of uncertainty into the credit community's dealings with corporate entities, that increases the risk of non-payment, diminishes the chances of recovery in insolvent situations, and creates a loophole potentially capable of immunizing virtually every corporate distribution, whether large or small, from the legitimate claims of creditors. As a consequence, the effect of the Tenth Circuit's decision is to discourage voluntary settlements and encourage bankruptcy filings in order to gain the advantage of a new set of rules that is not warranted by the language of the bankruptcy code and was not within the intent of Congress. These new rules are contrary to the historic principles governing the distribution of assets of insolvent corporations that apply in non-bankruptcy situations and are contrary to the justified expectations of trade creditors dealing with corporate debtors. Moreover, the magnitude of cases to which this loophole may apply is enormous, ranging beyond the large and well publicized public takeovers of the past decade to include virtually every corporate stock transaction structured to include payment through a financial institution or brokerage house. As such, CMAC and its members have a substantial interest in the issues raised by this case. CMAC and its members therefore urge the Court to grant Kaiser

Steel Resources, Inc.'s ("Kaiser") petition for writ of certiorari because it presents important issues and because the lower court's decision departs significantly from the accepted course of decisions in this area of the law.

ARGUMENT

The Impact of the Decision Below on Trade Creditors is of Such a Magnitude That Immediate Review is Required

In its Petition, Kaiser points out the importance of the question raised to the 7,000 Kaiser retirees. It notes, almost in passing, the $250 to $500 million in unsecured creditors' claims that are being left largely unpaid in Kaiser's Chapter 11, while Kaiser's shareholders received $162,000,000 from the corporation's assets. While these creditors' may not present as sympathetic a symbol of the human devastation resulting from the LBO as do Kaiser's retirees, they should nonetheless be seen as a reminder of the impact of the lower court's decision on the national economy. When the depletion of corporate assets through an LBO results in insolvency, the burden of the transaction is invariably borne by the trade creditors of the failed business. As Kaiser points out, the LBO's of the 1980's were funded by debt typically running as high as 90% of capitalization. While the bank debt incurred in these transactions is repaid, it is the suppliers of goods and services and the other debt included in the transactions that remain unpaid.

Kaiser has demonstrated the magnitude of the impact of the LBO's of the 1980's in terms of the staggering amounts involved in the large, well-publicized transactions involving public companies. This alone presents a compelling argument for the need for immediate review of

the Tenth Circuit's decision. However, it is really only the tip of the iceberg. The Tenth Circuit's holding is equally applicable to any LBO that is accomplished through the use of a financial institution, stockbroker or clearing agency, regardless of whether or not publicly traded securities are involved. Some of the distributions immunized by the Tenth Circuit opinion were made directly by Bank of America to beneficial shareholders without passing through clearing agency and stock broker intermediaries.

Any LBO in which the payments are made by a bank arguably would fall within the protection of section 546(e) under the Tenth Circuit's interpretation. This literally would eliminate the ability of a trustee or creditors to avoid any LBO transaction. Even if the mere payment by a bank is not enough, structuring a transfer of corporate assets to shareholders through one of the enumerated qualifying intermediaries in order to launder those assets would be a painfully easy step. If Congress had intended by section 546(e) to make LBO distributions unavoidable it would surely have said so. Its use of the term "settlement payment," with its well defined meaning in the securities industry, indicates an entirely different and far more limited purpose: to protect the certainty of market trading activity. Protecting existing shareholders' receipt of consideration for the corporation to retire their stock is not within the scope of that purpose. Moreover, the protection of these shareholders at the expense of trade creditors represents an overturning of the basic principals of debtor-creditor relations in the corporate setting by leap-frogging the interests of equity over those of debt. This inequitable result, which is contrary to the normal expectations of the commercial community, should be reviewed and revised. Therefore, Kaiser's petition should be granted.

CONCLUSION

The decision of the Tenth Circuit is contrary to recognized law and causes an unjust and inequitable result. The impact on the nation's credit community is substantial and therefore the petition should be granted.

April 29, 1992

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In the Supreme Court of the United States

OCTOBER TERM, 1991

KAISER STEEL RESOURCES, INC., FKA
KAISER STEEL CORP., PETITIONER

v.

PEARL BREWING COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether leveraged buyout payments are settlement payments for purposes of Section 546(e) of the Bankruptcy Code, 11 U.S.C. 546(e), and thus excluded from certain of the avoidance provisions of the Code.

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1A-26A) is reported at 952 F.2d 1230. The order of the district court (Pet. App. 1H-7H) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on December 30, 1991. The petition for a writ of certiorari was filed on March 30, 1992 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In January 1984, the shareholders of Kaiser Steel Corporation, the predecessor company of petitioner Kaiser Steel Resources, Inc. (Kaiser), voted to approve a leveraged buyout (LBO) of the company. The terms of the merger agreement through which the LBO was effected required the owners of Kaiser common stock to tender their shares in return for $22 in cash plus preferred stock in the surviving company. Pursuant to that agreement, Kaiser's shareholders were paid approximately $162 million in cash. Pet. App. 13A.

The Bank of America, Kaiser's disbursing agent to carry out the terms of the merger, was authorized to receive the common stock and to distribute payments to Kaiser's shareholders. Most of the common stock was in the possession of the Depository Trust Company (DTC), a securities clearing agency. DTC tendered the shares to the Bank of America in return for the LBO payments. DTC then transferred the payments to its participants, including brokers and other financial intermediaries. The financial intermediaries, in turn, either disbursed the payments to their customers who were the beneficial owners of the Kaiser stock, or retained the payments in the case of broker-dealers who were themselves the beneficial owners.[1] Pet. App. 13A-14A.

2. Three years later, in February 1987, Kaiser filed a petition for voluntary reorganization pursuant to

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[1] Some shares were exchanged through securities clearing agencies other than DTC, and some payments were made directly by the Bank of America to financial intermediaries and beneficial owners without going through DTC, which stopped handling Kaiser's stock prior to the effective date of the LBO. Pet. App. 14A.

Chapter 11 of the Bankruptcy Code. Subsequently, Kaiser commenced a fraudulent conveyance action seeking to recover the $162 million in payments made pursuant to the LBO. It named as defendants both the financial intermediaries that received the payments as record owners (and then paid the funds to the beneficial owners) and the beneficial owners themselves. The latter group included broker-dealers that held Kaiser shares in proprietary accounts as well as other shareholders. Pet. App. 14A-15A.[2]

Charles Schwab & Co., a broker-dealer acting solely as a financial intermediary, filed a motion for summary judgment arguing that it was not liable because it acted as a conduit for the payments rather than as a transferee. Because the motion was treated as a test case on the legal issues, other defendants intervened and argued, in support of Schwab's motion, that the LBO payments were exempt from avoidance under Sections 546(e) and 741(8) of the Bankruptcy Code, 11 U.S.C. 546(e) and 741(8), because the payments constituted "settlement payments" made by or to a stockbroker.[3] The district court ruled in favor of

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[2] The Securities and Exchange Commission participated in this case pursuant to 11 U.S.C. 1109(a), which states that "the Commission may raise and may appear and be heard on any issue in a case under" Chapter 11 of the Code. The Commission's role is to act as an advisor to the court and it seeks primarily to protect the interests of public investors. Although the Commission may not file its own appeals under Section 1109(a), it may appear as a party in appeals brought by other parties, see Pet. App. 9J n.7, and it did so in the current case.

[3] Section 546(e) provides in pertinent part:

> Notwithstanding sections 544 [allowing trustee to invoke state fraudulent conveyance laws] * * * [and] 548(a)(2) [the Code provision permitting avoidance of "constructively" fraudulent transfers] * * * of this title, *the trustee may not*

Schwab on both grounds. Pet. App. 14A; *Kaiser Steel Resources, Inc.* v. *Jacobs (In re Kaiser Steel Corp.)*, 110 B.R. 514 (D. Colo. 1990) (Pet. App. 14F-16F).

Subsequently, the district court held that the remaining financial intermediaries were also entitled to summary judgment on the ground that the LBO payments made to them were exempt from avoidance as "settlement payments" made by or to a stockbroker, financial institution, or securities clearing agency. Pet. App. 1H-6H. In addition, the district court stated *sua sponte* that it would be appropriate to grant summary judgment to the defendants who were the beneficial owners of Kaiser's common stock. *Id.* at 6H. After briefing on the applicability of Section 546(e) to the beneficial owners, the district court issued an order granting summary judgment to the remaining financial intermediary defendants and most of the beneficial owner defendants. *Id.* at 7H.[4]

> *avoid a transfer that is a * * * settlement payment, as defined in * * * section 741(8) of this title*, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title [avoidance of transfers made within one year of filing a petition and with actual intent to defraud].

11 U.S.C. 546(e) (emphasis added). Section 741(8) defines a "settlement payment" as:

> a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade * * *.

11 U.S.C. 741(8).

[4] The district court excluded from its summary judgment order certain former stockholders known as the Jacobs Group. Pet. App. 15A n.2, 1I. That group had owned a large block of

3. Petitioner appealed the district court's decision as to Schwab. The court of appeals affirmed, holding that the payments made by Kaiser pursuant to the LBO were "settlement payments" for purposes of Section 546(e). *Kaiser Steel Corp.* v. *Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990).[5] The court relied on three factors in reaching its conclusion. First, the Court noted that the Code's definition of "settlement payment," as found in Section 741(8), is "extremely broad," and other courts have rejected a narrow definition of the term. Pet. App. 5J-6J, quoting *Bevill, Bresler & Schulman Asset Management Corp.* v. *Spencer Sav. & Loan Ass'n*, 878 F.2d 742, 747 (3d Cir. 1989). Second, the court stated that a broad interpretation "is consistent with the legislative intent behind § 546(e) to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions." Pet. App. 6J, quoting *Kaiser Steel Resources, Inc.* v. *Jacobs*, 110 B.R. at 522. Finally, the court determined that interpreting the term "settlement payment" to include the transfer of consideration for securities in an LBO is consistent with the way "settlement" is defined in the securities industry. Pet. App. 8J-9J.

The court of appeals rejected Kaiser's argument that the term "settlement payment" should be restricted to routine securities trading transactions and should not be applied to LBOs and other exceptional transactions. Pet. App. 9J. The court concluded that "because of the variety and scope of different securities transactions, and the absence of any

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Kaiser stock and had received a payment from Kaiser not to oppose the LBO. See Pet. 3.

[5] The court of appeals' opinion in *Schwab* is *reprinted at* Pet. App. 1J-10J.

restrictions in sections 546(e) and 741(8), it would be an act of judicial legislation to establish such a limitation." *Ibid.*

4. Petitioner appealed as to the remaining defendants in whose favor the district court had granted summary judgment. In light of *Schwab*, petitioner abandoned its claims against the defendants insofar as they acted in the capacity of financial intermediaries. The remaining defendants were, therefore, "shareholders or brokers that beneficially owned the Kaiser Steel shares tendered in connection with the LBO." Pet. App. 15A. The court of appeals framed the issue as whether its holding in *Schwab* that payments made to the financial intermediaries were "settlement payments" under Section 546(e) "should be extended to protect payments made to the beneficial shareholders." Pet. App. 15A. Examining Section 546(e)'s language and purpose, the court held that it should. *Id.* at 15A-23A.

As it had done in *Schwab*, the court noted that the statutory definition of "settlement payment" is extremely broad. The court stated that the "clear aim of the definition is to encompass all 'settlement payments' commonly used in the securities trade." Pet. App. 17A. The court rejected petitioner's argument that Section 546(e) is limited to routine securities transactions, stating that no such limitation appears on the face of the statute. *Id.* at 21A. The court further explained that the Kaiser LBO was in substance a securities transaction in which Kaiser shareholders sold their equity interests for money and preferred stock; the shareholders who tendered their shares therefore received payments in "settlement" of that transaction. Pet. App. 23A. The court concluded that applying Section 546(e) to such payments furthers the policy of that provision to

ensure the finality of securities transactions. Pet. App. 23A n.10.[6]

ARGUMENT

The court of appeals held that the LBO payments made by Kaiser were "settlement payments" within the meaning of 11 U.S.C. 546(e). That holding does not conflict with any decision of this Court or of any other court of appeals. Moreover, the decision is consistent with the plain language and purpose of the relevant Bankruptcy Code provision. Review by this Court is therefore not warranted.

1. As petitioner recognizes (Pet. 11), no other court of appeals has addressed the question of whether LBO payments are "settlement payments" for purposes of Section 546(e) of the Bankruptcy Code. Petitioner nonetheless posits a conflict "[i]n a broad sense" with case law holding that creditors can recover corporate distributions to shareholders that render the company insolvent. Pet. 8-9. None of those cases, however, involved Section 546(e). This case involves the distinct issue of whether LBO payments are shielded by Section 546(e), a provision reflecting Congress's specific determination that securities "settlement payments" are protected from recovery under the Bankruptcy Code's avoidance provisions except in cases involving actual fraud that arise within one year before the date a bankruptcy petition is filed.

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[6] The court of appeals also rejected petitioner's claim that Section 546(e) does not protect a settlement payment made *by* a stockbroker, financial institution, or clearing agency unless that payment is made *to* another participant in the clearance and settlement system. Pet. App. 24A-26A. The court concluded that the plain language of the statute applies to payments "*by or to*" the enumerated entities. *Ibid.* Petitioner does not renew that claim in this Court.

The authorities cited by petitioner do not take that provision or its underlying policies into account.[7]

2. Petitioner argues (Pet. 12-14) that the protection afforded to securities settlement payments under Section 546(e) should be limited to the context of "a market trade where shares and money are exchanged between buyers and sellers" and that it should not be applied to transactions like the Kaiser LBO. There is no basis, however, for construing the term "settlement payment" to apply only in the context of exchanges of securities in open trading markets. The definition of "settlement payment" in Section 741(8) is not limited to such transactions, but applies broadly to a "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C. 741(8).[8]

The payments involved here fit within the commonly understood meaning of "settlement." Most of the payments at issue were made by a financial institution (Kaiser's disbursing agent, the Bank of America), first to a clearing agency (DTC) and then

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[7] Nor does the claimed conflict (Pet. 11) between the decision of the court of appeals here and the district court decision in *Wieboldt Stores, Inc.* v. *Schottenstein*, 131 B.R. 655 (N.D. Ill. 1991), warrant review by this Court.

[8] Other lower court cases construing the term "settlement payment," albeit not in the context of an LBO, have interpreted the term broadly. See *Bevill, Bresler & Schulman Asset Management Corp.* v. *Spencer Sav. & Loan Ass'n*, 878 F.2d 742 (3d Cir. 1989); *Jonas* v. *Farmer Bros. (In re Comack)*, 124 B.R. 806 (Bankr. C.D. Cal. 1991); *Blanton* v. *Prudential-Bache Securities, Inc. (In re Blanton)*, 105 B.R. 321 (Bankr. E.D. Va. 1989).

by that clearing agency to a stockbroker. The court of appeals properly construed Sections 546(e) and 741(8) in a way that is consistent with the ordinary meaning of the term "settlement" within the securities industry. Pet. App. 18A-20A. The term "settlement" as used in the securities industry refers to "[t]he completion of a transaction, wherein securities and corresponding funds are delivered and credited to the appropriate accounts." Group of Thirty, *Clearance and Settlement Systems in the World's Securities Markets* 86 (1989). See also A. Pessin & J. Ross, *Words of Wall Street* 227 (1983) (defining "settle" as "[i]ndustry term for the completion of a securities transaction (i.e., a buyer pays for and a seller delivers the security purchased to the buyer")). The payments in this case, although made pursuant to an LBO rather than in the course of ordinary secondary market trading, were nonetheless made in exchange for securities and were effected through normal settlement channels. These payments "settled" the Kaiser LBO transaction.[9]

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[9] The clearance and settlement process ordinarily involves three separate procedures: (1) "comparing" trades whereby buyers and sellers agree through their brokers to exchange securities in the public market at a given price; (2) "accounting for" trades, whereby the terms of the settlement obligations—deliver or receive, price and quantity—are established; and (3) "settling" trades, whereby delivery and receipt of funds and securities occurs, in discharge of previously established obligations. See generally Securities Exchange Act Rel. No. 13,163, 42 Fed. Reg. 3916, 3920 nn.54-56 (1977) (describing the clearance and settlement process). While the Kaiser LBO did not involve the first two procedures, which relate to the *clearance* of securities transactions, the Kaiser LBO did involve the third procedure, which relates to the *settlement* of securities transactions.

Moreover, Section 741(8) defines "settlement payment" to include not only a variety of specific settlement payments, but also "any other similar payment commonly used in the securities trade." 11 U.S.C. 741(8). Payments made to shareholders pursuant to the LBO of a public corporation are, at the very least, "similar" to settlement payments made in the securities markets in other contexts. The similarity flows from the fact that the Kaiser LBO entailed the exchange of Kaiser's common stock for funds in a transaction through which the company effectively purchased the stock and the shareholders sold it. The payment made to consummate that transaction is functionally equivalent to a settlement payment.[10]

3. Petitioner errs in its reliance (Pet. 13-14) on the legislative history to support a restrictive reading of "settlement payments." In light of the breadth of the statutory language, and the explicit reference to the "securities trade" as providing the relevant context, see 11 U.S.C. 741(8), it is doubtful that recourse to legislative history is required. See *Barnhill* v. *Johnson*, 112 S. Ct. 1386, 1391 (1992); *Connecticut National Bank* v. *Germain*, 112 S. Ct. 1146, 1149 (1992); *Union Bank* v. *Wolas*, 112 S. Ct 527, 531 (1991); *Toibb* v. *Radloff*, 111 S. Ct. 2197, 2200 (1991). But, in any

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[10] Contrary to Kaiser's assertion (Pet. 17), the LBO payments were not the practical equivalent of dividend payments. The LBO payments were made in exchange for stock pursuant to the terms of a merger that required shareholder approval. Dividends, in contrast, do not involve an exchange and are declared by directors. Moreover, the LBO payments extinguished the interests of the former shareholders in the Kaiser stock; shareholders receiving a dividend usually retain their stockholdings.

event, the legislative history is of no avail to petitioner.

The legislative history of Sections 546(e) and 741(8) does not discuss the intended scope of the term "settlement payment." The general purpose of these provisions, however, is to protect the integrity of the securities clearance and settlement systems by "prevent[ing] the insolvency of one * * * security firm from spreading to other firms and possibly threatening the collapse of the affected market." H.R. Rep. No. 420, 97th Cong., 2d Sess. 1 (1982). Congress sought to promote the liquidity of participants in the securities industry by preventing debtors from invalidating margin, settlement, and similar payments or deposits by using the Bankruptcy Code's avoidance provisions to reverse settled securities transactions.[11]

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[11] An impetus behind these amendments was the fear that the avoidance sections of the Code, as originally enacted, could be construed as invalidating margin, settlement, and similar type payments made by a broker or customer who became insolvent. The amendments were designed to "ensure that the avoiding powers of a trustee are not construed to permit [such securities payments] to be set aside except in cases of fraud." H.R. Rep. No. 420, *supra*, at 2. Beyond the obvious disruption caused by the risk of participants' undoing completed securities transactions, Congress was concerned about the risk resulting from a change in the market price between the time a transaction has been entered into and the time of settlement. *Id.* at 1 (protections are needed "[b]ecause of the structure of the clearing systems in these industries and the sometimes volatile nature [of] the markets"). Often the price of securities can vary significantly in that period. For that reason, participants could be exposed to significant risks in the event that the market moves away from the price at which the trade was made and another participant fails to perform. That particular concern is generally not relevant in transactions such as the Kaiser LBO that involve set prices.

Kaiser argues (Pet. 17-18) that the scope of Section 546(e) should be restricted to the specific problems discussed in the congressional hearings that led to its enactment—the protection of brokers and clearing agencies that stand behind the obligations of an insolvent customer or broker. See *Bankruptcy of Commodity and Securities Brokers: Hearings Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 97th Cong., 1st Sess. 243-245 (1981). But "[i]t is not the law that a statute can have no effects which are not explicitly mentioned in its legislative history." *Pittston Coal Group* v. *Sebben*, 488 U.S. 105, 115 (1988).[12] While the hearings focused upon the system of guarantees through which the clearance and settlement process operates and the potential harm to the process if payments among participants such as brokers and clearing agencies can be voided because of a bankruptcy, nothing in the legislative history indicates any intention on the part of Congress to exclude payments made to shareholders from the coverage of the statute.

Interpreting Section 546(e) to include payments received by beneficial owners who are themselves part of the clearance and settlement system furthers the congressional purpose of protecting the system from instability attributable to bankruptcies. Allowing recovery from those beneficial owners that are

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[12] Cf. *Union Bank* v. *Wolas*, 112 S. Ct. at 531 (construing the plain language of 11 U.S.C. 547(c)(2) to exempt from certain of the Code's avoidance provisions long-term debt payments made in the ordinary course of business, even though the legislative history indicated only that the provision was designed to address problems of trade creditors and issuers of commercial paper, not the problems of conventional long-term lenders).

broker-dealers or financial institutions could threaten the stability of the clearance and settlement system. It makes no difference whether the broker from whom the payments are recovered was an intermediary for customers or a beneficial owner. The broker would be confronted in either case with the unanticipated need to make a substantial payment and could as a result face a capital or liquidity problem. The broker might be unable to meet its other securities trading obligations. Others in the chain of guarantees could be placed at risk by the broker's failure. The insolvency of a major brokerage firm could mean that a clearing agency would have to draw on its clearing fund, thereby potentially requiring an increase in the clearing-fund contribution from other members to compensate for the added risk due to the insolvency.[13]

3. Petitioner argues (Pet. 21-28) that review is warranted because the decision below has harmful consequences for the creditors of a bankrupt corporation that underwent an LBO.[14] Review is not warranted for that purpose. While protecting settlement payments to shareholders will diminish the funds available for distribution to creditors, that consequence follows from Congress's balancing of the need to protect creditors against the need to protect settle-

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[13] That scenario is also possible, although less likely, when settlement payments are recovered from individual shareholders who are not part of the clearance and settlement system. The system could be implicated if such a shareholder, as a result of the recovery, were unable to meet outstanding trading obligations of such a magnitude that the broker would be affected as well.

[14] The creditors in this case include employees, retirees, and trade and bank creditors, as well as the Pension Benefit Guaranty Corporation.

ment payments made by or to participants in the settlement system. By enacting Section 546(e), Congress determined that settlement payments made by or to stockbrokers, financial institutions, or clearing agencies should be shielded from the full reach of the creditor protections of the fraudulent conveyance laws, with recovery permitted only for transfers that involve actual fraud and occur within one year of a bankruptcy petition. If that scheme results in harm to creditors or others affected by an LBO, the remedy lies with Congress. See *Union Bank* v. *Wolas*, 112 S. Ct. at 533.

CONCLUSION

The petition for a writ of certiorari should be denied.

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v.
PEARL BREWING COMPANY, et al., and SECURITIES AND EXCHANGE COMMISSION, *Respondents*

KAISER STEEL RESOURCES, INC., formerly known as KAISER STEEL CORPORATION, *Petitioner*
v.
ACTION TRADERS, INC., et al., and SECURITIES AND EXCHANGE COMMISSION, *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITIONER'S REPLY

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PETITIONER'S REPLY

Several assertions in the briefs in opposition warrant a short reply.

1. **The Meaning of "Settlement Payment."** The central legal issue in this case is the meaning of "settlement payment" in section 546(e) of the Bankruptcy Code. In response to Kaiser's massive showing on this question, the private respondents (who include a number of arbitrageurs) claim that Kaiser's distributions to its shareholders were "settlement payments" because the SEC says so and because other courts have said the term should be interpreted broadly.

But it is clear that the SEC never said so until its attorneys filed their briefs in the Kaiser proceedings below. Neither in its advocacy of this legislation (Pet. at 13-15) nor afterwards did the SEC promulgate any regulation or order, or issue any interpretive bulletin or other policy pronouncement, which would even suggest either that (i) the SEC deemed section 546(e) to have any possible application to a corporation's distributions to shareholders (such as the old Kaiser management accomplished here), or (ii) that the SEC regarded such a far-reaching extension of section 546(e) as having any legitimate or significant role in stabilizing securities markets. The SEC attorneys' belated espousal of such a view does not warrant any deference whatever from the courts.

In its brief to this Court, the SEC has argued that the LBO distributions fit within the commonly understood meaning of settlement payments because most (but by no means all) of the monies were distributed through the same accounts used for settling stock trades. So are dividends, redemption payments and other corporate distributions — all are called "post-settlement services," not "settlement payments," by the same Group of Thirty source cited by the SEC for its conclusion (SEC Br. at 9;

Pet. at 17). Both of the SEC's quoted sources limit "settlement payments" to those securities transactions they define as the sale of shares. Those transactions and only those transactions generate "settlement payments . . . in the securities trade," according to all industry publications and expert testimony (Pet. at 12).

All three decisions cited by the private respondents and the SEC as precedent for a broad interpretation of section 546(e) dealt with open market trades. They have no applicability to the Kaiser situation. At most, they show the importance of court regard for the views of securities industry experts, entirely disregarded here. *Bevill, Bresler* was amply discussed at page 18 of our petition, and its lack of relevance is clear. *Jonas v. Farmer Bros. Co. (In re Comark)*, 124 B.R. 806, 815-16 (Bankr. C.D. Cal. 1991), held, based on expert testimony at trial, that transactions at issue there were repo contracts for the simultaneous sale and future repurchase of assets. *Blanton v. Prudential-Bache Securities, Inc. (In re Blanton)*, 105 B.R. 321, 345-48 (Bankr. E.D. Va. 1989), held, again based on trial evidence, that cash transfers to meet margin calls were either settlement payments or margin payments. The only other reported decision interpreting section 546(e) — apart from *Wieboldt*, to which we return at page 4, below — is *Wider v. Wootton*, 907 F.2d 570 (5th Cir. 1990), which read the section 546(e) exemption narrowly. *Wider* construed the term "stockbroker" instead of "settlement payment," but it did aptly refuse to approve any "unjustified extension of the stockbroker defense," even if the consequences to the particular defendant were "harsh." 907 F.2d at 573.

2. **The Legislative History.** The SEC asserts that legislative history is irrelevant here, in light of the "breadth" of statutory language and its specific securities trade context. If the Tenth Circuit had defined the breadth of the term by the securities trade definitions of what is and is not a settlement, that might be true. The express reference to the securities trade definition to determine the term's plain meaning sets this case apart from the

other Bankruptcy Code cases where this Court considered legislative history to be unimportant. It sets this case apart from *Pittston Coal Group v. Sebben*, 488 U.S. 105, 115 (1988) as well, for in *Pittston* the text of the statute "plainly embraced" criteria of more general application than described in the history. Payments pursuant to all sorts of settlements are not embraced by section 546(e), only those in the securities trade.

The Code reference to "similarity" also sets this case apart. As Kaiser noted in its petition, similarity must be judged by the object and policy of the statute, evidenced by its history (Pet. at 17). The private respondents and SEC recognize this, contending that Congress weighed the policies of fraudulent conveyance law against the policies of securities market stability in enacting section 546(e). That stability is threatened when trades may be set aside, because of the guarantees by brokers and clearing agencies who did not make investment decisions, but stood behind the decisions of others to make the market function smoothly. Without the guarantee liability and risks inherent in a volatile market, that concern is significantly diminished if not obviated altogether with respect to corporate distributions..

Contrary to the SEC's assertion, the legislative history does demonstrate that Congress sought to exclude from the scope of section 546(e) any transactions other than those guaranteed-trades described to it. It narrowed the statutory language based on testimony that bankruptcy trustees should continue to recover on traditional avoidance actions (Pet. at 14-15). Congress never sought to overturn fundamental, long-established liability of beneficial shareholders for the corporate distributions they received. No one showed Congress or any court in this case that market stability depended on reversing that liability. By its unwarranted innovation, the Tenth Circuit judicially legislated from words meant for others. It stepped far outside existing law, in a manner no one contends Congress ever actually contemplated, in exempting beneficial shareholders from existing liabilities, the consequences of their

choices. These beneficial shareholders are largely the participants in "risk arbitrage" who opposed Kaiser's petition, after playing the market with the recognition that they could lose substantial sums on one transaction and gain substantially on another. They should not be shielded from existing liability on the pretext that Congress evaluated their risks.

3. **The SEC's Policy Concerns.** The SEC has expressed a concern that liability of broker-arbitrageurs could lead to unanticipated substantial payments, which could result in capital or liquidity problems, in turn leading to inability to meet other securities trading obligations. Not only would any such payments be long-anticipated, made at the conclusion of litigation or settlement, but the SEC and securities exchanges have in place an elaborate safety net to guard against such risks. These include the SEC's net capital requirement (17 C.F.R. § 240.15e3-1), New York Stock Exchange Rule 326 (net capital, indebtedness, and reserve requirements), and the Securities Investor Protection Act (15 U.S.C. § 78aaa *et seq.*). The adequacy of these mechanisms and the extent of the risk are legislative concerns, and yet have never been presented to Congress. It is conceivable that Congress, weighing the rights of creditors against owners, might decide to insulate owners distributing to themselves as the SEC desires. But this might never happen and has not happened yet.

4. **The *Wieboldt* Case.** The private respondents contend (Br. Opp. at 9) that the *Wieboldt* case is somehow or other consistent with the Tenth Circuit decisions here, because the *Wieboldt* defendants were insider shareholders facing claims of intentional fraud committed within a year of bankruptcy under Bankruptcy Code section 548(a)(1), and section 546(e) does not preclude such claims. The *Wieboldt* case expressly held, however, that section 546(e) does not bar a bankruptcy trustee's fraudulent conveyance claims under the constructive fraud provision of section 548(a)(2) and state law, against selling shareholders in a leveraged buyout. *Wieboldt Stores, Inc. v. Schottenstein*, 131 B.R. 655, 663 n.8 (N.D. Ill. 1991). On non-section 546(e) grounds the

court did dismiss claims against shareholders who had no notice that Wieboldt assets were being encumbered or even distributed to them, in what appeared to be a tender offer by a new entity. But here all the Kaiser shareholders had such notice from the prospectus prompting their vote for the LBO; several of the present respondents had considerably more inside knowledge. Our petition at page 11 showed *Wieboldt* to be in direct conflict with the Tenth Circuit, and the Tenth Circuit in its opinion properly acknowledged the existence of a direct conflict (Pet. at 24A note 10).

5. **Kaiser's Alleged "Concession."** The private respondents quote at length (Br. Opp. at 5) an alleged "concession" by Kaiser at an oral argument on the stockbroker defendants' motion for summary judgment before any Tenth Circuit rulings in this case. Kaiser straightforwardly argued that the LBO distribution was not a "settlement payment" as understood in the securities industry or contemplated by the drafters of section 546(e). Kaiser acknowledged that if the court were to treat LBO distributions as "settlement payments," the decision might be expected to have far-reaching ramifications. This was a prediction as to probabilities, that have been manifest in the successive holdings of the Tenth Circuit and the Jacobs Group's motion for summary judgment (see Pet. at 3). The Tenth Circuit fully reviewed the issue and decided on the merits, recognizing it was not restricted by any so-called "concession." The admittedly broad ramifications of its ruling underscore the need for review by this Court at this time.

CONCLUSION

The strong grounds presented in our petition showing the national importance of granting certiorari have in no way been diminished by the briefs in opposition filed by the private respondents or by the government. The broad impact of the Tenth Circuit's decision has received additional emphasis from the brief *amicus curiae* which the Credit Managers Association of California has submitted in support of our petition. And as the govern-

ment has noted, as a result of the Tenth Circuit's decision, governmental creditors are being deprived of significant recoveries of fraudulently conveyed assets. This is particularly true of the Pension Benefit Guaranty Corporation, whose most substantial and immediate financial exposure is now from companies in or close to bankruptcy. See GAO Financial Audit, Pension Benefit Guaranty Corporation's 1991 and 1990 Financial Statements (March 1992), p. 12. Such deprivation is unwarranted because Congress never struck the balance between creditor recoveries of insolvent companies' corporate distributions and possible stock market repercussions. It never elevated the interests of equity over debt, as held by the Tenth Circuit.

For the reasons summarized in our petition for certiorari and in this reply, certiorari should be granted.

RESPECTFULLY SUBMITTED, June 1992.

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